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Supreme Court of the United States

OCTOBER TERM, 1993

ITT CONSUMER FINANCIAL CORP., AETNA FINANCE CO., ITT LYNDON PROPERTY INS. CO., ITT LYNDON LIFE INS. CO., JOHN M. HIGGINS AND ASAD ZAFARI,
Petitioners,

v.

ABBE KANAREK PATTERSON, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the California Court of Appeal First Appellate District

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PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

May a court apply state-law principles of adhesion and unconscionability to deny enforcement of an arbitration agreement covered under the Federal Arbitration Act, 9 U.S.C. §§ 1, *et seq.*?

LIST OF PARTIES

In addition to the parties listed in the caption, the parties below include respondents Johnny Davis, Ann Ruth Gonsalves, Christine Graham, James P. Jacobs, Thomas Pierce, Zenia M. Velasco, Bruce J. Hodes, Paul Embley, Pamela L. Embley, Donna Wessells, Jorge De La O, and John Lang. Pursuant to Rule 29.1, the corporate petitioners have the following parent corporations and non-wholly owned subsidiaries: ITT Financial Corporation is the parent of ITT Consumer Financial Corporation, ITT Lyndon Property Insurance Company, and ITT Lyndon Life Insurance Company. ITT Consumer Financial Corporation is the parent of Aetna Finance Company. ITT Corporation is the parent of ITT Financial Corporation.

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PETITION FOR WRIT OF CERTIORARI

ITT Consumer Financial Corporation, Aetna Finance Company, ITT Lyndon Property Insurance Company, ITT Lyndon Life Insurance Company, John M. Higgins, and Asad Zafari (collectively "ITT" or "petitioners") hereby petition this Court for a writ of certiorari to review the judgment of the California Court of Appeal, First Appellate District.

OPINIONS AND ORDERS BELOW

The August 12, 1993 order of the Supreme Court of California in this case denying discretionary review

is unreported and reproduced at Appendix ("App.") 1a, *infra*. The California Court of Appeal's May 13, 1993 order denying rehearing is unreported and reproduced at App. 2a. That court's April 19, 1993 opinion is reported at 14 Cal. App. 4th 1659 and reproduced at App. 3a-13a.

JURISDICTION

The Supreme Court of California issued its order denying review in this case on August 12, 1993. The California Court of Appeal decision affirming denial of ITT's motion to compel arbitration is final for purposes of this Court's jurisdiction. *Southland Corp. v. Keating*, 465 U.S. 1, 6-8 (1984) ("For us to delay review of a state judicial decision denying enforcement of the contract to arbitrate until the state-court litigation has run its course would defeat the core purpose of a contract to arbitrate" and "might 'seriously erode federal policy'.").

This petition is being filed within the time permitted by the Rules of this Court as extended by the December 6, 1993 Order of Justice O'Connor (A-370). This Court has jurisdiction over this case pursuant to 28 U.S.C. § 1257(a).

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

1. The Supremacy Clause of the Constitution, U.S. Const. art. VI, cl. 2, provides, in pertinent part:

> The Constitution, and the Laws of the United States which shall be made in pursuance thereof . . . shall be the supreme Law of the Land; and the judges in every state shall be bound thereby,

> any thing or Laws of any State to the contrary notwithstanding.

2. The Federal Arbitration Act, 9 U.S.C. § 2, provides, in pertinent part:

> § 2. Validity, irrevocability, and enforcement of agreements to arbitrate
>
> A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

STATEMENT OF THE CASE

This case presents the important question whether and under what circumstances a court may invoke state-law contract principles of adhesion and unconscionability to nullify otherwise valid and enforceable arbitration agreements covered by the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1, *et seq.*

The arbitration provisions at issue appear in a series of consumer loan agreements. ITT provides consumer loans, insurance, and related services. Abbe Kanarek Patterson and the other respondents borrowed money from ITT. As part of these transactions, several of the respondents agreed to arbitrate any disputes arising out of the loans and other services.

Respondents executed an "AGREEMENT FOR DISPUTE RESOLUTION," a one-page document separate from the loan agreement. Printed conspicuously in the middle of the page, directly above where each respondent signed the agreement, was a subheading entitled "ARBITRATION," which provided that all disputes arising between respondent and petitioners "shall be resolved by binding arbitration by the National Arbitration Forum, Minneapolis, Minnesota." The entire "Agreement for Dispute Resolution," including the foregoing provision, is printed in large type in upper case letters with each subheading, including **"ARBITRATION,"** in bold face.[1]

Respondents initiated this case by filing a class action against ITT in California state court, asserting various state tort and contract claims with respect to their loan and insurance transactions.[2] ITT petitioned the trial court for an order compelling arbitration of the claims of those respondents who had signed arbitration agreements, and moved for a stay of the pending action in which those respondents had joined.

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[1] Respondent John Lang's arbitration agreement differs slightly but not materially in that it appears in bold face in the body of the loan agreement he executed. The front of Lang's loan agreement provides in bold type, immediately above where Lang signed the agreement: **"You agree to all the terms and conditions on both sides, including binding arbitration."**

The chief difference between Lang's agreement and those of the other respondents is that the former contains a $3,000 jurisdictional carve-out, permitting either party to use small claims court.

[2] Lang subsequently filed a similar action as an individual plaintiff. The *Patterson* and *Lang* cases were heard together because of the common issues presented.

ITT explained that "the transactions underlying the arbitration clause at issue here involved interstate commerce and . . . [that] the Federal Arbitration Act therefore governs the resolution of this dispute." Memorandum of Points and Authorities in Support of Petition for Order Compelling Arbitration and Motion to Stay the Pending Action at 4. ITT argued that the FAA "preempts contrary state laws," and "evidences a 'federal policy favoring arbitration'," *id.* at 3 (quoting *Moses H. Cone Memorial Hosp. v. Mercury Construction Co.*, 460 U.S. 1, 24 (1983)), and that the United States Supreme Court has "directed . . . courts . . . 'rigorously [to] enforce agreements to arbitrate'." *Id.* (quoting *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 226 (1987)).

Respondents did not deny signing the arbitration agreements and did not allege that they were fraudulently induced to do so. They simply asserted that they had not read the arbitration agreements.

The trial court examined the arbitration agreements, concluded that they were unconscionable and therefore unenforceable, and on that basis denied ITT's petition to compel arbitration. App. 15a. The court's conclusion was based on its perception of inadequacies in the arbitration rules and procedures referenced in the arbitration agreements. Even though none of the respondents acknowledged having read the arbitration agreements, or the National Arbitration Forum ("NAF") Rules referenced therein, the court found that the arbitration agreements and the NAF Rules and procedures might lead borrowers to the erroneous conclusion that the arbitration provisions required arbitration hearings to be held in Minnesota (the court acknowledged, however, that the

NAF Rules required arbitration hearings in San Francisco if respondents so requested). The court found also that the NAF Rules regarding waiver of fees in the case of indigency were not understandable, and that the NAF requirement of an affidavit of poverty in order to apply for a fee waiver is "not acceptable to the average borrower." App. 16a. The trial court went on to enjoin ITT from confirming any NAF administrative awards in San Francisco County. App. 17a.

ITT timely appealed the trial court's order to the California Court of Appeal. ITT argued that the FAA, and the strong federal policy favoring arbitration, precluded application of state principles of unconscionability to deny enforcement of the arbitration agreements. Appellant's Opening Brief at 12-16.

The Court of Appeal affirmed. Relying exclusively on California law, the Court of Appeal held that the arbitration agreements were adhesion contracts and were unconscionable. App. 10a. The Court of Appeal affirmed the trial court's determination that some borrowers might mistakenly believe that they must go to Minnesota to arbitrate, and that the NAF Rules regarding waiver of fees in the case of indigency were difficult to understand. Although neither the trial court nor the Court of Appeal made a finding that any respondent was actually misled or otherwise harmed by the arbitration agreements, the Court of Appeal denied enforcement of the agreements based on its speculation that the arbitration procedures might deny a hypothetical borrower an "opportunity to a hearing, much less a hearing held where the contract was signed, unless the borrower has consid-

erable legal expertise or the money to hire a lawyer and/or prepay substantial hearing fees." App. 8a. The Court of Appeal concluded, without any record support, that the NAF's rules and procedures "come perilously close" to denying this theoretical borrower a " 'fair opportunity to present his position.' " App. 9a (quoting *Graham v. Scissor-Tail, Inc.*, 28 Cal. 3d 807, 826, 623 P.2d 165 (1981)).

ITT timely filed a petition for rehearing with the California Court of Appeal. The court summarily denied that petition on May 13, 1993. App. 2a.

ITT timely petitioned for review by the California Supreme Court. In the petition, ITT again asserted that the FAA and federal policy preclude application of state adhesion and unconscionability principles to prevent enforcement of the arbitration agreements. Petition Review for Appellants at 10-16. The California Supreme Court summarily denied the petition for review on August 12, 1993. App. 1a.

REASONS FOR GRANTING THE WRIT

The California Court of Appeal denied enforcement of arbitration agreements on the basis of a state-law determination that arbitration rules and procedures rendered the agreements unconscionable. The California court's manifest hostility toward arbitration is contrary to the strong federal policy in favor of arbitration, and threatens the enforcement of arbitration provisions common in consumer loan and other commercial contracts. The court's application of state law conflicts directly with the rule in the Ninth Circuit that the enforcement of arbitration agreements subject to the FAA is exclusively a matter of federal law. Moreover, the Court of Appeal decision is symp-

tomatic of a larger confusion among the state and federal courts—resulting from inconsistency in this Court's decisions—concerning when, if ever, state-law contract principles may be applied to deny enforcement of arbitration agreements. Review of this case will resolve that confusion.

A. The California Court Of Appeal Decision Conflicts With the Federal Policy Favoring Arbitration And With The Rule In The Ninth Circuit That The Enforcement Of Arbitration Agreements Is Governed Exclusively By Federal Law

The arbitration provisions at issue in this case are part of loan agreements between California residents and a lender incorporated in Delaware, with its principal place of business in Minnesota, engaged in nationwide consumer lending. These provisions are therefore part of contracts involving interstate commerce and thus plainly within the scope of the FAA.[3] The FAA declares that such provisions "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2.

Congress enacted the FAA to reverse the long-standing judicial hostility to arbitration agreements that American courts had adopted from the English

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[3] *See* 9 U.S.C. §§ 1, 2; *Mesa Operating Ltd. Partnership v. Louisiana Intrastate Gas Corp.*, 797 F.2d 238, 243 (5th Cir. 1986) ("[c]itizens of different states engaged in performance of contractual operations in one of those states are engaged in a contract involving commerce under the FAA"); *Snyder v. Smith*, 736 F.2d 409, 418 (7th Cir.) ("it is clear that the 'involving commerce' language must be construed very broadly"), *cert. denied*, 469 U.S. 1037 (1984). *See also Prima Paint v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 401-02 n.7 (1967) (contract need only "relat[e] to interstate commerce").

common law. *Gilmer v. Interstate/Johnson Lane Corp.*, 111 S. Ct. 1647, 1651 (1991); *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219-20 & n.6 (1985). "Section 2 is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24 (1983). State rules antagonistic to arbitration are preempted by the FAA pursuant to the Supremacy Clause. *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984) ("[i]n creating a substantive rule applicable in state as well as federal courts, Congress intended to foreclose state . . . attempts to undercut the enforceability of arbitration agreements").

This Court has explained that *federal* law applies to the enforcement of arbitration agreements within the scope of the FAA. FAA section 2 "creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate." *Moses H. Cone*, 460 U.S. at 25 n.32. Such federal law is applicable in both state and federal courts and creates a strong presumption in favor of the enforcement of arbitration agreements: " 'The preeminent concern of Congress in passing the Act was to enforce private agreements into which parties had entered,' a concern which 'requires that [courts] rigorously enforce agreements to arbitrate.' " *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625-26 (1985) (quoting *Dean Witter*, 470 U.S. at 221). Courts are to apply federal law—and doubts about enforceability "should be resolved in favor of arbitration"—"whether the problem at hand is the construction of the contract language itself or an allegation of waiver,

delay, or a like defense to arbitrability." *Moses H. Cone*, 460 U.S. at 24-25.

In light of these pronouncements, the Ninth Circuit has concluded that the question of enforcement of arbitration agreements under the FAA is exclusively one of federal law. That court rejects outright all application of state-law principles of adhesion and unconscionability. State-law principles may not be invoked to bar arbitrability of disputes under the FAA in the Ninth Circuit. *Mago v. Shearson Lehman Hutton Inc.*, 956 F.2d 932, 934 (9th Cir. 1992) (" 'state law adhesion principles may not be invoked to bar arbitrability of disputes under the [FAA]' ") (quoting *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 286 (9th Cir. 1988)). *See also Bayma v. Smith Barney, Harris Upham and Co.*, 784 F.2d 1023 (9th Cir. 1986); *Hall v. Prudential-Bache Securities, Inc.*, 662 F. Supp. 468, 470 (C.D. Cal. 1987).

The California Court of Appeal decision in this case is squarely inconsistent with the rule articulated and enforced in the federal Circuit that encompasses California. The California court applied state principles of adhesion and unconscionability to defeat the arbitration agreements. The Ninth Circuit would not permit such a result in a case brought in a federal court in California.

Moreover, the California court's application of state law was antagonistic to arbitration. Despite the absence of any evidence that any of the respondents had been defrauded or misled by the agreements, the court refused enforcement because of a perceived imbalance in bargaining power and its determination that borrowers *might* draw the wrong conclusions about the arbitration rules and procedures established

by their contracts. App. 7a. The court was concerned in particular that, despite NAF Rules to the contrary, hypothetical borrowers might believe that they would have to travel to Minnesota for an arbitration hearing,[4] or would have to pay certain fees up front. *Id.* These concerns led the court to the erroneous conclusion that the "NAF's rules and procedures" "come perilously close" to denying the borrower a "fair opportunity to present his position." App. 9a.

This decision represents a return to the "anachronistic judicial hostility to agreements to arbitrate," that the FAA was designed to overcome. *See Mitsubishi Motors*, 473 U.S. at 625 n.14. The Court of Appeal found the arbitration agreements unconscionable precisely because of perceived unfairness in the rules and procedures of the National Arbitration Forum. This Court has rejected similar efforts to undermine the arbitration mechanism. Such "attacks on arbitration 'res[t] on suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants,' and as such they are 'far out of step with our current strong endorsement of the federal statutes favoring this method of resolving disputes.' " *Gilmer*, 111 S. Ct.

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[4] As the Court of Appeal acknowledged, the NAF Rules call for a hearing in the federal judicial district where the arbitration agreement was signed. App. 7a. The court nonetheless held the arbitration agreements unconscionable because respondents *might have been* misled into believing that they had to arbitrate in Minnesota. *Id.* But neither the Court of Appeal nor the trial court made a finding that any of the respondents were so misled. Indeed, it would have been impossible for respondents to have made such a claim, because they had not read the arbitration provisions.

at 1654 (quoting *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 481 (1989)).

Had the California court applied federal substantive law, as the Ninth Circuit would, the arbitration agreements here would have been enforced. In line with the federal presumption in favor of arbitration, other courts, both state and federal, have applied federal substantive law to enforce arbitration agreements in standard form contracts despite allegations of unconscionability and unequal bargaining power.[5] *E.g.*,

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[5] Questions of adhesion and unconscionability, at issue in the present case, are questions of contract enforcement. As the California Court of Appeal explained, the question here was not whether an agreement to arbitrate existed, but whether it would be enforced. *See* App. 5a-10a ("Since a contract of adhesion is still fully enforceable, the inquiry then turns to whether enforcement should be denied . . . . We conclude that the arbitration provision in the loan agreement is unconscionable and thus unenforceable."). *See also* Cal. Civ. Code § 1670.5(a) (West 1993) ("If the court as a matter of law finds the contract . . . to have been unconscionable at the time it was made the court *may refuse to enforce* the contract") (emphasis added).

Respondents have argued that the California Court of Appeal ruled on the *existence* of the arbitration agreements. Respondents are wrong, but even if the California Court of Appeal had determined that no arbitration agreements existed, the application of state law to that issue would have placed the California court on one side of a question that has divided the federal Courts of Appeals. *Compare Eassa Properties v. Shearson Lehman Brothers*, 851 F.2d 1301, 1304 n.7 (11th Cir. 1988) ("[w]hile federal law may govern the interpretation and enforcement of a valid arbitration agreement, state law governs the question whether such an agreement exists in the first instance") *with In re Hart Ski Mfg. Co.*, 711 F.2d 845, 846 (8th Cir. 1983) ("federal law governs the question of whether the parties have agreed to arbitrate"). *See also Cook Chocolate Co. v. Salomon*,

Cohen, 841 F.2d at 286; *Coleman v. Prudential Bache Securities, Inc.*, 802 F.2d 1350, 1352 (11th Cir. 1986); *Webb v. R. Rowland & Co.*, 800 F.2d 803, 806-07 (8th Cir. 1986); *David v. Merrill Lynch, Pierce, Fenner and Smith, Inc.*, 440 N.W.2d 269, 274 (N.D. 1989); *Passage v. Prudential-Bache Securities, Inc.*, 727 P.2d 1298, 1302 (Mont. 1986), *cert. denied*, 480 U.S. 905 (1987); *Shotto v. Laub*, 632 F. Supp. 516, 522-23 (D. Md. 1986); *Finkle and Ross v. A.G. Becker Paribas, Inc.*, 622 F. Supp. 1505, 1511-12 (S.D.N.Y. 1985).[6] This Court has asserted the strong federal policy in favor of arbitration in just such cases. *E.g.*, *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 225-26 (1987) (arbitration agreement in form contract between individual customers and large brokerage house); *Gilmer*, 111 S. Ct. at 1651 (arbitration agreement in form contract between individual employee and New York Stock Exchange).

The difference in the law applied to arbitration agreements in the Ninth Circuit and in the courts of California, and the obvious difference in results it produces, will inevitably generate forum shopping and erode the value of arbitration agreements. Those who wish to interdict an arbitration will take advantage of the hostility to arbitration that still flourishes in

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Inc., 684 F. Supp. 1177, 1181 (S.D.N.Y. 1988) (noting the split of authority). Review of this case will allow the Court to clarify this issue and resolve this important split among federal appellate courts.

[6] In fact, courts have enforced under federal law agreements virtually identical to those here, calling for arbitration under the NAF Rules. *E.g.*, *DiCrisci v. Lyndon Guaranty Bank of New York*, 807 F. Supp. 947, 950-51 (W.D.N.Y. 1992); *ITT Consumer Financial Corp. v. McNaughton*, 8 I.E.R. Cases (BNA) 808, 1991 WL 519584 (N.D. Ala. Apr. 12, 1991).

the California courts. Review by this Court is necessary to resolve this division of authority, and reestablish the supremacy of the federal law preserving the validity of arbitration agreements.

B. The Court Of Appeal Decision Is Symptomatic Of Confusion Among State And Federal Courts As To Whether And Under What Circumstances State Law May Be Used To Deny The Enforcement Of Arbitration Agreements

The California Court of Appeal decision in this case not only is contrary to the rule in the Ninth Circuit, but also is inconsistent with decisions of other federal and state courts that have applied federal law to the questions of adhesion and unconscionability of arbitration agreements. *See supra* at 13. Those courts are consistent in applying federal law to arbitration enforcement.[7]

There is, however, an important inconsistency between those other federal and state decisions and the

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[7] *See also Neal v. Hardee's Food Systems, Inc.*, 918 F.2d 34, 37 n.5 (5th Cir. 1990) ("[f]ederal law governs the interpretation and validity of an arbitration clause subject to the Federal Arbitration Act"); *Flink v. Carlson*, 856 F.2d 44, 46 n.2 (8th Cir. 1988) ("the question of what persons are bound by an arbitration agreement concerning interstate commerce is a question of federal law"); *Genesco, Inc. v. T. Kakiuchi & Co.*, 815 F.2d 840, 845 (2d Cir. 1987) ("[i]n enacting the Federal Arbitration Act, Congress created national substantive law governing questions of the validity and the enforceability of arbitration agreements under its coverage"); *Cost Brothers, Inc. v. Travelers Indemnity Co.*, 760 F.2d 58, 60 (3d Cir. 1985) ("questions of the construction of arbitration agreements and their enforceability are governed by federal substantive law"); *Shearson Lehman Hutton, Inc. v. McKay*, 763 S.W.2d 934, 937 (Tex. Ct. App. 1989) ("[t]he issue of whether a party is bound by an arbitration clause is determined by federal law").

decisions of the Ninth Circuit. The Ninth Circuit not only applies federal law to arbitration enforcement, it explicitly rejects *any* application of state law to arbitration agreements. But the other federal and state courts that apply federal law do not rule out the possibility that state law might apply under some circumstances. Moreover, the First and Fourth Circuits *will* apply state law to arbitration agreements if the law is arbitration-neutral. *Securities Industry Ass'n v. Connolly*, 883 F.2d 1114, 1120-21 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990); *Saturn Distrib. Corp. v. Williams*, 905 F.2d 719, 725-26 (4th Cir.), *cert. denied*, 498 U.S. 983 (1990). This division reflects a growing confusion in federal and state courts as to when, if ever, state law may apply to the enforcement of arbitration agreements within the scope of the FAA. That confusion results from a tension in this Court's FAA decisions.

The primary source of the tension is *Perry v. Thomas*, 482 U.S. 483 (1987). FAA section 2 declares that agreements to arbitrate are "valid, irrevocable and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract*" (emphasis added). The Court explained in *Perry* that the validity, irrevocability, and enforceability of arbitration agreements are determined "*as a matter of federal law.*" *Id.* at 492 n.9. This rule is consistent with declarations in *Moses H. Cone* and other FAA cases that section 2 "creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate." 460 U.S. at 25 n.32. That rule, standing alone, is consistent with the standard that most federal and state courts have been applying.

The *Perry* Court also observed in dictum, however, that state law may be applicable to arbitration agreements, pursuant to the savings clause of FAA section 2, "*if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." 483 U.S. at 492-93 n.9. Thus, *Perry* suggested that a court may apply general state contract law to an agreement to arbitrate if the state law is neutral in its application to arbitration. "A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement." *Id.* The Court explained in particular that the neutrality requirement applies to state-law principles of unconscionability: "Nor may a court rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." *Id.*[8]

The *Perry* dictum that neutral state-law principles may be applicable to the enforcement of an arbitration agreement appears to conflict with the Court's numerous other pronouncements that the enforcement of an arbitration agreement must be determined as a matter of *federal* substantive law. *See supra* at 9-10; *see also Coenen v. R.W. Pressprich & Co.*, 453 F.2d 1209, 1211 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972) ("[o]nce a dispute is covered by the Act, federal law applies to all questions of interpretation, construction, validity, revocability, and enforceability") (cited with approval in *Moses H. Cone*, 460 U.S. at

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[8] The court below ignored this requirement. The Court of Appeal's decision on unconscionability was not the application of a rule applicable to "any contract," but rather displayed a particular hostility to arbitration based on perceived (but nonexistent) unfairness of arbitration rules and procedures.

25 n.31). As a result, federal and state courts are confused and seriously divided on the question whether state law might be applied under some circumstances to deny the enforcement of arbitration agreements.

Following *Perry*, the First and Fourth Circuits have held that arbitration-neutral state law is applicable to the enforcement of arbitration agreements under the FAA. For example, in *Securities Industry Ass'n*, the First Circuit held that "Massachusetts could . . . pass legislation declaring all contracts of adhesion presumptively unenforceable. . . . Such a rule would apply to arbitration contracts, *among others*. But Massachusetts may not say (judicially, legislatively, or in a regulatory mode) that 'adhesion contracts are especially bad when arbitration is included.'" 883 F.2d at 1121 (citations omitted). And in *Saturn Corp.*, the Fourth Circuit concluded that "[i]f Virginia . . . declared all contracts of adhesion to be presumptively unenforceable, then the statute at issue would not be at odds with general contract law." 905 F.2d at 725-26. *See also W.M. Schlosser Co. v. School Board of Fairfax County*, 980 F.2d 253, 258-59 (4th Cir. 1992) (enforcing Virginia rule that local school board had no authority to arbitrate disputes because the rule "is not an idiosyncratic rule specific to arbitration agreements, but is instead merely an unremarkable part of Virginia's general laws of contract formation") (internal quotations omitted), *cert. denied*, 113 S. Ct. 2340 (1993).

The approach taken by the First and Fourth Circuits is completely inconsistent with the rule in the Ninth Circuit, which determines the enforcement of arbitration agreements exclusively on the basis fed-

eral law, rejecting all application of state-law adhesion and unconscionability principles. Moreover, the decisions of other federal and state courts that have applied federal law to the enforcement of arbitration agreements line up more closely with the Ninth Circuit rule than with that of the First and Fourth Circuits. Although those other courts do not explicitly reject application of state law, as does the Ninth Circuit, neither do those courts look to generally applicable state-law principles in enforcing arbitration agreements. Those decisions have thus complicated further the issue whether and under what circumstances state law may be applied to arbitration agreements.

Review of this case will enable the Court to clarify the growing general uncertainty about the application of state law and to remove the threat that it poses to the utility and efficiency of arbitration agreements under the FAA.

C. By Defeating Federal Policy, The Court Of Appeal Decision Threatens The Continued Viability Of Tens Of Thousands Of Arbitration Agreements

The California Court of Appeal applied state law with a presumption against enforcement of arbitration agreements in cases of perceived imbalance in bargaining power. That decision undermines the future viability of arbitration in California, and in every other State that may be tempted to embrace California's hostility to arbitration.

Thousands of form contracts calling for arbitration of disputes are executed each day in California. Such agreements are commonplace in the purchase of securities, in employment, and in franchising. In industries such as consumer lending and insurance, such

contracts are essential. Without the use of standardized time-tested agreements, repeated consumer loan and insurance transactions simply would not be possible. Moreover, the availability of "the simplicity, informality, and expedition of arbitration," *Mitsubishi Motors*, 473 U.S. at 628, encourages such transactions, and lowers the cost of loans and insurance for consumers. *See Securities Industry Ass'n*, 883 F.2d at 1124 ("Arbitration is a positive good in the eyes of courts and Congress not just because it relieves crowded calendars, but because it relieves an often unnecessary elaboration of social practices."). The California court's antipathy toward arbitration agreements threatens the viability of every such agreement. The court's decision strikes a devastating blow to a form of alternative dispute resolution favored by Congress, and eliminates the efficiencies of the form contract, in the Nation's most populous State.

The potential application of unconscionability rules like those the California Court of Appeal applied here will encourage prolonged and expensive litigation on the collateral issue of arbitrability, contrary to the entire purpose of arbitration: "Contracts to arbitrate are not to be avoided by allowing one party to ignore the contract and resort to the courts. Such a course could lead to prolonged litigation, one of the very risks the parties, by contracting for arbitration, sought to eliminate." *Southland Corp.*, 465 U.S. at 7.

Congress enacted the FAA precisely to eliminate the kind of judicial hostility toward arbitration evinced by the California courts in this case. The FAA, together with this Court's repeated declarations of the "liberal federal policy favoring arbitration agreements," *Moses H. Cone*, 460 U.S. at 24, have en-

couraged agreements to arbitrate as a means of swift, inexpensive dispute resolution. The California Court of Appeal decision calls into question all of these agreements, executed in reliance on the FAA and this Court's decisions. Review by this Court is necessary to reverse this unfortunate ruling and interrupt its damaging consequences.

CONCLUSION

For the foregoing reasons, the Court should grant a writ of certiorari and set the case for plenary review.

December 17, 1993

Respectfully submitted,

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FIRST APPELLATE DISTRICT, DIVISION FOUR,
NO. A057729 S033123

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

IN BANK

ABBE KANAREK PATTERSON Et Al.,
Respondents

v.

ITT CONSUMER FINANCIAL CORPORATION Et Al.,
Appellants

SUPREME COURT

FILED

Aug. 12, 1993

Appellants' petition for review DENIED.

/s/ LUCAS
Chief Justice

COURT OF APPEAL OF THE STATE OF CALIFORNIA

IN AND FOR THE

FIRST APPELLATE DISTRICT

DIVISION: 4

PATTERSON, ABBE KANAREK, ET AL.
vs.
ITT CONSUMER FINANCIAL CORPORATION ET AL
A057729 Old No. A059641
San Francisco County No. 936818

BY THE COURT:

The petition for rehearing is denied.

Dated: May 3, 1993 /s/ ANDERSON, P.J.

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FOUR

ABBE KANAREK PATTERSON et al.,
Plaintiffs and Respondents,
v.
ITT CONSUMER FINANCIAL CORPORATION et al.,
Defendants and Appellants.

FILED

Apr. 19, 1993

A057729

(San Francisco Super. Ct. No. 936818)

Defendants, ITT Consumer Financial Corporation, Aetna Finance Company, ITT Lyndon Property Insurance Company, ITT Lyndon Life Insurance Company, and John M. Higgins (collectively ITT), appeal from an order denying their petition to compel arbitration and prohibiting them from confirming arbitration awards in San Francisco County. Plaintiffs Abbe Kanarek Patterson et al., are individuals who borrowed money from defendant finance companies and who, in connection with those loans, purchased insurance policies from defendant insurers.

In September 1991 plaintiffs filed a class action alleging ITT had violated the Consumer Legal Remedies Act (Civ. Code, § 1750 et seq.), engaged in unfair debt collection practices (Civ. Code, § 1788 et seq.), unlawfully made collateral sales a condition upon obtaining loans, breached the loan agreement with respect to insurance payments and refunds, engaged in false advertising, intentionally in-

flicted emotional distress, and committed fraud. A companion case containing many of the same allegations was filed on behalf of an individual plaintiff, John Lang, a few months later.

ITT petitioned for an order to compel arbitration under the following provision which was part of the loan agreement signed by each plaintiff:[1] "You and ITT financial services agree that, other than judicial foreclosures and cancellations regarding real estate security, any dispute, past, present, or future, between us or claim by either against the other . . . whether related to your loan, products you purchase from or through ITT Financial Services, or otherwise, shall be resolved by binding arbitration by the National Arbitration Forum, Minneapolis, Minnesota and judgment upon any award by the arbitrator may be entered in any court having jurisdiction. We agree that the transactions between us are in interstate commerce and this agreement shall be subject to 9 USC § 1-14, as amended."[2]

After a contested hearing the court denied defendant's petitions to compel arbitration, finding that the arbitration clauses were unconscionable and hence unenforceable. The court also ordered defendants not to seek confirmation in San Francisco County of any arbitration awards, but permitted defendants to pursue their claims in San Francisco small claims or superior court actions.

ITT appeals contending that the trial court erred when it found the arbitration agreements to be unconscionable. They also contend that the order prohibiting them from confirming arbitration awards against plaintiffs who were not parties to this action was improper.

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[1] The Lang and Patterson cases were not consolidated but were heard together, apparently because of the common issue presented.

[2] A slightly different version was signed by plaintiff Lang which applies arbitration to "any dispute exceeding $3,000 (including class claims which in the aggregate exceed $3,000)."

Discussion

I. Arbitration Clause

A. Standard of Review

Unconscionability is ultimately a question of law. (*A & M Produce Co.* v. *FMC Corp.* (1982) 135 Cal.App.3d 473, 489.) To the extent that there are conflicts in the evidence or in the factual inferences which may be drawn from the evidence a finding of unconscionability by the trial court will be upheld if it is supported by substantial evidence. (*Ibid.*) If, however, there is no evidence extrinsic to the contract or no conflict in the extrinsic evidence or the conflicting evidence is entirely written, a reviewing court is not bound by the finding of the trial court, but instead subjects the contract to independent review. (*Milazo* v. *Gulf Ins. Co.* (1990) 224 Cal.App.3d 1528, 1534.) In this case what extrinsic evidence there was, was entirely written. Thus, even to the extent that the evidence may be in conflict, this court reviews the arbitration clause de novo.

B. Unconscionability

Two alternative analyses exist under California law for determining whether a contractual provision will be unenforceable because it is unconscionable. (*Perdue* v. *Crocker National Bank* (1985) 38 Cal.3d 913, 924, fn. 8 ["Both [analytical] pathways should lead to the same result."].) The first model set out in *Graham* v. *Scissor-Tail, Inc.* (1981) 28 Cal.3d 807 asks initially whether the contract is one of adhesion. (*Id.* at p. 819.) Since a contract of adhesion is still fully enforceable, the inquiry then turns to whether enforcement should be denied. First, enforcement will be denied if the contract or provision falls outside the reasonable expectations of the weaker party. (*Id.* at p. 820.) Second, enforcement will be denied even if it does fall within the reasonable expectations of the parties, but it is unduly oppressive or unconscionable. (*Ibid.*).

The alternative analytical model was set out in *A & M Produce Co.* v. *FMC Corp., supra,* 135 Cal.App.3d 473. It sought to define what rendered a contract or a contractual provision unconscionable and hence unenforceable under Civil Code section 1670.5. (*Id.* at p. 485.) *A & M* concluded that unconscionability has a procedural and a substantive component. (*Id.* at p. 486.) The procedural component focuses on the factors of oppression and surprise. (*Ibid.*) Oppression results where there is no real negotiation of contract terms because of unequal bargaining power. (*Ibid.*) " 'Surprise' involves the extent to which the supposedly agreed-upon terms of the bargain are hidden in a prolix printed form drafted by the party seeking to enforce the disputed terms." (*Ibid.*) The substantive component of unconscionability looks to whether the contract allocates the risks of the bargain in an objectively unreasonable or unexpected manner. (*Id.* at p. 487.) To be unenforceable there must be both substantive and procedural unconscionability, though there may be an inverse relation between the two elements. (*Ibid.*)

A contract of adhesion is "a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it." (*Neal* v. *State Farm Ins. Cos.* (1961) 188 Cal.App.2d 690, 694.) The record before us indicates that plaintiffs are individuals of modest means, some self-employed or temporarily jobless, who borrowed relatively small amounts of money, often in response to advertising promising "guaranteed loans." The loan agreement which they signed included a preprinted form containing an arbitration clause either as the final paragraph on a page entitled "Agreement for Dispute Resolution" or at midpage on a sheet of text, but set apart by the use of boldface type. On both versions of the form the provision was clearly titled "Arbitration." None of the preprinted clauses had been modified in any manner which suggests that they were

nonnegotiable. Several of the borrowers stated that they believed they would not have been able to obtain a bank loan. In these circumstances we think it indisputable that the contract was one of adhesion.

ITT argues that arbitration has become such a common means of dispute resolution that it must be considered within the reasonable expectation of the borrowers. While arbitration per se may be within the reasonable expectation of most consumers, it is much more difficult to believe that arbitration in Minnesota would be within the reasonable expectation of California consumers. The arbitration clause says only that the dispute will be "resolved by binding arbitration by the National Arbitration Forum, Minneapolis, Minnesota."

At the time the agreement is signed the borrowers were not given a copy of the procedural rules of the National Arbitration Forum (NAF)—the rules were sent to the borrowers only once ITT had initiated a claim against them. Indeed in her declaration NAF's director of arbitration asserted that "[i]t is not possible for the National Arbitration Forum to advise a claimant or respondent of the location of the Participatory Hearing before a claim is brought or a response entered . . . ." Thus, at the time the agreement was signed even a borrower who inquired about where any arbitration would be held could not have received a definite answer from NAF. Meanwhile the provision on its face suggests that Minnesota would be the locus for the arbitration.

The NAF rules do permit a participatory hearing and state that it "shall be held in the United States federal judicial district or division where the respondent to the initial claim signed the arbitration agreement, *unless the arbitration agreement designates or the parties agree to a different location.*" (Emphasis added.) As the trial court concluded, a reasonable reader of this language might be-

lieve that by signing an agreement to arbitrate with NAF in Minnesota he had in fact agreed to that location.

Under NAF procedures if a borrower responds to notice of a claim with a written denial of responsibility sent to Minnesota, the borrower is found to have conferred jurisdiction on NAF in Minnesota. The result will be an arbitration conducted without appearances by either side and based solely on the submitted documents. Arbitration based solely on documents does not entail payment of fees by the responding party.

In order to obtain a participatory hearing, however, the responding party must make a prompt demand for one and accompany it with prepayment of fees.[3] Prepayment of hearing fees can be waived for individuals, but only after filing an affidavit of indigency. However, the rule explaining the fee waiver process is, as the trial court aptly noted, "incomprehensible," since it requires compliance with rules concerning involuntary dismissals.

The likely effect of these procedures is to deny a borrower against whom a claim has been brought any opportunity to a hearing, much less a hearing held where the contract was signed, unless the borrower has considerable legal expertise or the money to hire a lawyer and/or prepay substantial hearing fees. The latter is especially unlikely given the small dollar amounts at issue. In a dispute over a loan of $2,000 it would scarcely make sense to spend a minimum of $850 just to obtain a participatory hearing. In short the procedure seems designed to discourage borrowers from responding at all. In the event that they do not respond, an award may be entered against them if the documents submitted by ITT support its claim.

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[3] The NAF 1992 fee schedule calls for a filing fee on claims of up to $5,000 of 5 percent but not less than $98. Hearing fees for claims in that dollar range are $750 per three hour session. Additional fees are charged for discovery, written findings and expedited hearings.

While we cannot say that the notice of and implementation of NAF's rules and procedures deny the borrower a "fair opportunity to present his position," they come perilously close to doing so. (*Graham* v. *Scissor-Tail, Inc., supra,* 28 Cal.3d 807, 826.) While NAF's rules and fees might be fairly applied to business entities or sophisticated investors and to claims for substantial dollar amounts, those same procedures become oppressive when applied to unsophisticated borrowers of limited means in disputes over small claims.

Analyzed in *A & M Produce* terms these arbitration procedures bear upon the substantive element of unconscionability. The contractual risk of a dispute resolution process which is weighted heavily against the borrower being able to obtain a hearing seems particularly unreasonable in light of the much greater bargaining power of ITT and its reluctance to disclose even the mechanics of NAF arbitration until it makes an arbitration claim. (*A & M Produce Co.* v. *FMC Corp., supra,* 135 Cal.App.3d 473, 487.)

Moreover, there was evidence in the declarations of several plaintiffs that they had not read the arbitration provision nor had any ITT employee pointed it out to them at the time they signed the loan agreement. While failure to read the provision does not excuse compliance with it (*Madden* v. *Kaiser Foundation Hospitals* (1976) 17 Cal.3d 699, 710), it does establish actual surprise the unfairness of which is reinforced by ITT's failure to call the arbitration clause to the attention of its borrowers. (*A & M Produce Co.* v. *FMC Corp., supra,* 135 Cal.App.3d at p. 490.)

Thus, whether we analyze this arbitration clause as beyond the reasonable expectation of the borrower (in *Graham* v. *Scissor Tail* terms) or as substantively and procedurally unconscionable (under *A & M Produce*'s analysis), the result is the same.

ITT argues that plaintiffs failed to prove the oppression factor of the procedural prong of unconscionability because plaintiffs did not demonstrate that they could obtain loans only from ITT. In support of its position ITT cites *Dean Witter Reynolds, Inc.* v. *Superior Court* (1989) 211 Cal.App.3d 758. In that case a concededly sophisticated investor challenged a $50 termination fee applied to Individual Retirement Accounts (IRA). The court held "that the 'oppression' factor of the procedural element of unconscionability may be defeated, if the complaining party has a meaningful choice of reasonably available alternative sources of supply from which to obtain the desired goods and services free of the terms claimed to be unconscionable." (*Id.* at p. 772.) In *Dean Witter* the "record establish[ed] without conflict that other financial institutions offered competing IRA's which lacked the challenged provision." (*Id.* at p. 771.) The court concluded that the investor had completely failed to prove the procedural prong of unconscionability—there was no oppression since other entities offered an IRA without a termination fee, and there was no surprise since the fee had been disclosed to a sophisticated individual who would have understood the disclosure. (*Id.* at p. 771-772.)

Such is not the case here. These plaintiffs were individuals of modest resources who believed they would not have qualified for a conventional loan from a bank. Moreover, they were not purchasers of an IRA account, but applicants for a loan, many of whom were responding to advertisements from ITT for "guaranteed loans." There is nothing in this record to suggest that plaintiffs had a "meaningful choice of reasonably available alternative sources" of personal loans from lenders who would not require NAF arbitration.

We conclude that the arbitration provision in the loan agreement is unconscionable and thus unenforceable.

II. Order

At the time the petition to compel arbitration was denied plaintiff had filed a complaint on behalf of a class of similarly situated consumers, but as yet no class had been certified. Meanwhile ITT had pending in San Francisco Superior Court a number of petitions to confirm arbitration awards against potential members of the class. As the trial court stated, "ITT Consumer Financial Corporation has been filing its claims with the NAF in Minneapolis, MN, taking Defaults therefrom, based either upon borrowers' failures to appear or failures to respond to the NAF notice, then enforcing the Arbitration Awards in the Law and Motion Department of this Court by having them confirmed into California judgments."

In response to this practice and at the urging of plaintiffs' counsel that the court take some measure to enforce its ruling as to all ITT borrowers, the court issued an order directing ITT to refrain from seeking to confirm NAF arbitration awards taken by default. The order does permit ITT to pursue delinquent borrowers in San Francisco courts; thus ITT can pursue in judicial actions new claims or NAF arbitrated but as-yet-unconfirmed claims.[4]

ITT makes two arguments that the order is infirm. First, it contends plaintiffs had no standing to object to confirmation of arbitration awards against borrowers who were not named plaintiffs in this action. Second, it contends

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[4] The order further provides that a consumer against whom ITT files an action in a San Francisco court may not assert the arbitration agreement in order to obtain a stay of the court proceeding, nor may the consumer base a claim for wrongful conduct of ITT's failure to arbitrate. In recognition that a class was not yet certified, however, the court permitted any consumer not presently a plaintiff to ignore the order and assert the arbitration clause. In such an event the order directs that ITT shall not be penalized by having instituted a court action in compliance with the order.

that the order is overbroad and unnecessary under California law.

The standing of the plaintiffs is not really the issue. ITT objects that the order prohibits it from reducing *any* NAF default arbitration awards to judgment, not just those it might obtain against the named plaintiffs against whom it was seeking to compel arbitration. ITT ignores the fact that the *Patterson* case is plead as a class action.

Once jurisdiction over a matter is conferred upon a trial court it has all means necessary to carry its jurisdiction into effect. (Code Civ. Proc., § 187; *People* v. *Gonzalez* (1990) 51 Cal.3d 1179, 1257.) In addition to this general grant of authority courts are also authorized to issue temporary restraining orders and/or preliminary injunctions in class actions even before the class has been certified. (Code Civ. Proc., § 527.) Obviously, in this instance the order which issued arose in the context of a motion to compel arbitration, but that procedural happenstance does not act to deprive the court of authority to issue an order effectuating its conclusion that the arbitration clause is unenforceable, especially where there is a class action pending which potentially includes all California ITT borrowers. The order which issued was tailored to protect ITT's collection rights, but at the same time to permit plaintiffs to seek class certification. We conclude it is not overbroad.

Disposition

The order denying ITT's petition to compel arbitration and prohibiting it from confirming NAF default awards in San Francisco County is affirmed.

Poche, Acting P.J.

WE CONCUR:

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Perley, J.

_____

Reardon, J.

SUPERIOR COURT OF THE STATE OF CALIFORNIA

IN AND FOR THE CITY AND COUNTY OF SAN FRANCISCO

Case Nos. 936818 and 939316 (Actions not consolidated.)

ABBE KANAREK PATTERSON, ET AL.,
Plaintiffs,

v.

ITT CONSUMER FINANCIAL CORPORATION, ET AL.,
Defendants.

JOHN LANG,
Plaintiff,

v.

ITT CONSUMER FINANCIAL CORPORATION, ET AL.,
Defendants

FILED

MAY 19, 1992

[PROPOSED] ORDER DENYING DEFENDANTS' PETITIONS TO COMPEL ARBITRATION

On April 29, 1992, the Court held a hearing on these two non-consolidated actions. Defendants appeared by Sara Church Dinkler and Carey Linkon of Gibson, Dunn & Crutcher and John W. Cotton and Aaron C. Gundzik of LeBoeuf, Lamb, Leiby & MacRae. Plaintiffs appeared by Patricia Sturdevant and Kim E. Card of Sturdevant & Sturdevant and Brian Newcomb. Before the Court were defendants' Motion for Reconsideration of the Court's Or-

der Denying Petitions to Compel Arbitration and the Court's own proposed order to prohibit defendants from seeking, in San Francisco County Courts, confirmation of arbitration awards rendered by the National Arbitration Forum ("NAF"). After reviewing the briefs of the parties and entertaining oral argument, the Court entered the following Orders:

The Court grants defendants' Motion for Reconsideration and reviews its previous order in light of the evidence presented by defendants in their moving papers.

The Court finds the arbitration clauses unconscionable and denies defendant's petition to compel arbitration. The Court makes the following findings in respect thereto:

1. The arbitration clauses are printed on form contracts which are part of the transactions in which borrowers in the main borrow small amounts of money and are unrepresented by counsel; there are two different versions of arbitration clauses before the Court which differ slightly from each other depending on the date of the form contract in questions. Both versions are equally unconscionable for all of the reasons stated herein;

2. The arbitration clauses are neither negotiated nor negotiable;

3. A fair reading of the arbitration clauses is that any arbitration hearing is to be conducted at the NAF offices in Minneapolis, MN;

4. The borrowers are not given a set of NAF Arbitration Rules when they purportedly agree to be bound by these Rules by signing the loan document, but only after a claim is filed by ITT;

5. The Rules contain no intelligible, readily understandable notice to the borrower that an Arbitration Hearing may be had in the locale where the loan was signed; the NAF Rules as published in 1989 and 1992 contain ex-

tremely confusing directions to the borrower as to the manner in which a borrower may attempt to elect San Francisco, CA. as the site for a contested Arbitration hearing. The Arbitration Rules suggest that the Arbitration may be in the Federal Judicial District where the loan was signed by the borrower "unless the arbitration agreement designates or the parties agree to a different location." (NAF Code of Procedure Rule 32 (1992).) This language leads the borrower to believe that by signing the loan document which contains the Arbitration Clause he or she has already "otherwise agreed" to have the hearing in Minneapolis, MN;

6. The language of the Rules of the NAF regarding the waiver of the considerable fees for a participatory hearing is incomprehensible, in that the Rules speak of mandatory compliance with the standards of NAF Rules 41A and 41B which have nothing to do with fees;

7. Assuming that a borrower could divine the waiver of fees provisions, in order to avail himself or herself of them a borrower must file an affidavit of poverty, an act which is not acceptable to the average borrower and which discourages the use of such provisions. Moreover, such fee waivers are available only to those borrowers who are actually impoverished.

8. When a claim is filed by ITT before the NAF in Minneapolis, MN, a notice is mailed to the borrower by NAF suggesting that he or she contact NAF to assert any defenses he or she may have to the claim; defendant ITT concedes that the legal effect of such assertion of defenses would be to confer jurisdiction on NAF in Minneapolis, MN;

9. In practice, ITT Consumer Financial Corporation has been filing its claims with the NAF in Minneapolis, MN, taking Defaults therefrom, based either upon borrowers' failures to appear or failures to respond to the NAF notice, then enforcing the Arbitration Awards in the Law and

Motion Department of this Court by having them confirmed into California judgments.

10. In light of the Court's finding that the arbitration agreements are unconscionable, the Court further orders that Defendants are to refrain from seeking to confirm arbitration awards, pursuant to California Code of Civil Procedure section 1285, in San Francisco County Superior Court, where the arbitration award was rendered by the National Arbitration Forum or any of its arbitrators, either by default or administrative order;

11. Defendants shall refrain from taking any actions towards seeking Court approval, in San Francisco County Superior Court, of all petitions to confirm arbitration awards that are currently pending.

12. Subject to paragraph 18 of this Order, because defendants are unable to confirm, in San Francisco County Courts, arbitration awards that are rendered as a result of the arbitration agreements between them and their customers, defendants shall be permitted to file and pursue in the San Francisco County court that would otherwise have jurisdiction over such claim, any claim they have against any customer, notwithstanding the existence of a signed arbitration agreement with that customer;

13. At their option, defendants may withdraw all petitions to compel arbitration that are currently pending in the San Francisco County Superior Court and reassert the claims upon which those arbitrations were based in the San Francisco County court that would otherwise have jurisdiction over that claim.

14. Subject to paragraph 18 of this Order, in the event that defendants file any claim against any customer in any San Francisco County court pursuant to Paragraphs 12 and 13 of this Order, the customer may not assert the existence of the arbitration agreement in order to have the action stayed in the San Francisco Court. Moreover,

no customer against whom a claim has been filed in this court, as authorized by this Order, may assert that defendants' failure to arbitrate pursuant to the arbitration agreement constitutes an unfair debt collection practice or other wrongful or tortious act.

15. Subject to paragraph 18 of this Order, no customer or member of plaintiffs' proposed class may argue that defendants have waived their right to arbitrate claims against such persons because defendants have complied with Paragraphs 12 and 13 of this Order by filing a claim in the San Francisco courts.

16. Defendants' utilization of the San Francisco courts to assert claims against customers who have signed arbitration agreements is being done solely for the purpose of complying with this Order. Consequently, this Court finds and holds that defendants' utilization of the courts to enforce claims, as opposed to arbitration, does not constitute any waiver of defendants' ability to seek arbitration in other actions against other customers not covered by this order.

17. This order is effective April 29, 1992.

18. No class has yet been certified. The Court recognizes that Defendants' customers against which it wishes to assert claims are only potential members of a potential plaintiff class and, except for presently named plaintiffs, are not before this Court at this time. Accordingly, notwithstanding anything herein contained to the contrary, any such customer not before this Court shall have the option to elect to disregard this Order, and to respond to any court claim filed by Defendants by asserting the arbitration clause. In any such case, as to any such customer or customers so electing, paragraphs 12, 14 and 15 hereof shall not apply; no act of Defendants in reliance on this Order in having utilized the San Francisco courts to initiate claims against any such electing customers shall inure to the benefit of any such electing customers nor to the

detriment of Defendants in respect of any such claims, and in all respects the rights of the parties shall be unaffected by the filing of any such claims by Defendants in the San Francisco courts.

Dated: May 19, 1992 /s/ Laurence D. Kay
The Honorable Laurence D. Kay
San Francisco County Superior
Court Judge

(2)

No. 93-952

Supreme Court, U.S.
FILED
FEB 9 1994
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In The

Supreme Court of the United States

October Term, 1993

ITT CONSUMER FINANCIAL CORP., AETNA FINANCE CO., ITT LYNDON PROPERTY INS. CO., ITT LYNDON LIFE INS. CO., JOHN M. HIGGINS AND ASAD ZAFARI,

Petitioners,

v.

ABBE KANAREK PATTERSON, et al.,

Respondents.

On Petition For A Writ Of Certiorari To The California Court Of Appeal First Appellate District

OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the California Court of Appeal erred in applying general principles of contract law to determine the underlying validity of an arbitration provision alleged to be unconscionable and unenforceable because it effectively denied consumers a fair opportunity to present or defend claims.

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OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondents Johnny Davis, James P. Jacobs, Thomas Pierce, Zenia M. Velasco, Dona Wessels, Jorge De La O, and John Lang, on behalf of themselves and a proposed class of similarly-situated California consumers, (hereinafter referred to collectively as "Respondents"), respectfully request that this Court deny the Petition for Writ of Certiorari pending in this matter.

INTRODUCTION

This is a factually-unique case in which the California Court of Appeal was required to determine, as a matter of basic contract law, the underlying validity and enforceability of an arbitration provision. Based on evidence in the record and applying general principles of state contract law, the Court of Appeal held that the arbitration provision, which was contained in a standard form contract for small consumer loans, and which required California consumers to submit to arbitration in a forum located in Minneapolis, Minnesota, was unconscionable and therefore unenforceable.

The decision below raises no issue that is not conclusively resolved by the provisions of the Federal Arbitration Act itself, 9 U.S.C. §2, ("the FAA"), and by previous well-considered decisions of this Court. Furthermore, as Respondents will demonstrate in the sections following, there is no conflict between the decision of the Court of Appeal below and the decisions of the Ninth Circuit interpreting and applying the FAA. Rather, Petitioners have attempted to create the appearance of conflict, where none in fact exists, by deliberately ignoring an important distinction between two issues that arise in cases governed by the FAA. The first issue, which is the issue that arose in this case, is the question of the underlying validity and enforceability of the arbitration agreement. This Court has previously instructed that this determination is to be made according to general principles of state contract law. *See Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987); 9 U.S.C. §2. The second issue that frequently arises, but which was not present in any manner in this case, is the scope of the arbitrable issues under

an admittedly valid and enforceable arbitration agreement. This Court has ruled that such a determination is to be made as a matter of federal law. *See Moses H. Cone Memorial Hosp. v. Mercury Construction Co.*, 460 U.S. 1, 24-25 (1983). Once this important distinction is made between the *validity* of an arbitration provision under general principles of contract law, and the *arbitrability* of a particular dispute as a matter of federal law, it is quite clear that there is no conflict among the lower courts, and accordingly, there is no basis for this Court's review.

Moreover, as will be demonstrated herein, regardless of whether state or federal law applies, the result would be the same in this case. At bottom, what is before this Court is an arbitration provision that two courts, exercising *de novo* review of substantial evidence in the record, and applying long-established and generally-applicable principles of contract law, have found to be unconscionable and unenforceable. The Federal Arbitration Act itself, and the numerous decisions of this Court interpreting that statute, establish that an arbitration provision is rendered unenforceable or revocable "upon such grounds as exist in law or in equity for the revocation of any contract." 9 U.S.C. §2.[1] That is precisely the principle that

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[1] It is important to note that the record below is devoid of any evidence or finding, as a matter of fact or law, that the small consumer loan transactions at issue actually involved interstate commerce such that the Federal Arbitration Act applied. Petitioners argued in the courts below that the provision was governed by the FAA, and there was much briefing by both parties as to the applicability and requirements of federal law. Respondents denied that the FAA applied, however, because the transactions occurred entirely within California between California

was applied by the trial court and by the California Court of Appeal in this case. The state law standard for determining unconscionability applied by the court below is generally applicable to any contract provision, and is derived directly from federal common law. The decision below applying that standard to the disputed arbitration provision was limited to the unique facts of this case and was well supported by evidence in the record. The determination would not have been any different had the court applied federal common law.

Petitioners have also argued that the decision below indicates that California courts are hostile to arbitration agreements. This assertion is similarly contrary to established law. California courts, in particular the California Supreme Court, have repeatedly emphasized the state's strong policy favoring arbitration and the courts' willingness to enforce valid arbitration agreements. The arbitration agreement in this case was denied enforcement by the Court of Appeal solely because the unique facts and circumstances of this case clearly rendered the provision unconscionable as a matter of basic contract law. This very limited decision neither resulted from, nor evidenced any, hostility toward arbitration agreements. Nor does the decision conflict in any way with the provisions of the FAA, the decisions of this Court, or the decisions of the Ninth Circuit. Indeed, because the sole issue in this

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consumers and businesses licensed to make loans by the State of California. Respondents also argued that, regardless of whether the FAA applied, the preliminary determination as to whether a valid and enforceable agreement existed was to be made according to state law. *Perry v. Thomas, supra,* 482 U.S. 483, 492, n.9.

case is the basic validity of a contract provision, the case presents no federal question whatsoever.

STATEMENT OF THE CASE

This is a consumer class action in which Respondents, all lower and middle income consumers residing in California, allege that Petitioners engaged in unlawful, unfair, and fraudulent business practices in the soliciting, making, and collecting of small consumer loans, and in the collateral sale of credit insurance policies.[2] Respondents allege, *inter alia*, that Petitioners falsely advertised consumer loan products; deceived borrowers about the terms of loan transactions and loan documents; forced consumers to purchase various insurance policies as part of the loan transaction; deceived consumers about additional charges imposed for insurance; systematically churned borrowers' accounts; and engaged in a pattern of

[2] The original Complaint in this action was filed on September 26, 1991 on behalf of ten named plaintiffs and a proposed consumer class. A companion case was filed on behalf of Respondent John Lang. Only four of the original ten named plaintiffs in the *Patterson* action, and John Lang, signed loan documents containing the disputed arbitration provision. Two additional plaintiffs were added by a subsequent amended complaint. Thus, although there are twelve named plaintiffs in the action, only six are Respondents to this Petition. The remaining six plaintiffs, and all other members of the proposed class whose loan documents did not contain the arbitration provision are unaffected by the arbitration dispute. Thus, the parties have litigated substantive law and motion matters and proceeded with discovery as to the "non-arbitration" plaintiffs and other class members.

unlawful and abusive debt collection practices. Respondents allege causes of action under several California consumer protection statutes and common law theories of recovery, and seek class certification, injunctive and declaratory relief, restitution, compensatory and punitive damages, and attorneys' fees and costs.

After the action was initially removed to federal court, and subsequently remanded to the state court, Petitioners moved to compel arbitration against Respondents based on a standardized arbitration clause that was contained in one of the numerous standard form documents they were required to sign at the time they took out their loans. This provision purported to obligate Respondents to resolve any claims against ITT Financial Services "by binding arbitration by the National Arbitration Forum, Minneapolis, Minnesota." The provision also asserted that the transaction was in interstate commerce and subject to the Federal Arbitration Act, 9 U.S.C. §§1-14. Respondents opposed the motion to compel arbitration on several grounds, including, *inter alia*, that the provision was unconscionable in its setting, purpose and effect, and therefore unenforceable under general principles of contract law; and that Respondents did not know that the documents they were required to sign contained an arbitration provision, and did not knowingly consent to arbitration.

To support the claim of unconscionability, Respondents presented substantial evidence regarding the circumstances under which the arbitration agreements were signed, and the purpose and effect of the arbitration

provision.[3] As an initial matter, the evidence established that Respondents are all relatively unsophisticated consumer borrowers. The evidence also established that, at the time they took out their loans, these consumers were instructed to sign several documents, but were not aware and were not informed by Petitioners that one of the documents contained an arbitration provision. The evidence further established that the disputed provision was merely one paragraph on a form that, although titled "Agreement for Dispute Resolution," for most unsophisticated consumers, appeared to contain only customer service information, not contractual provisions.

The evidence also established that, by designating a distant, expensive, and inaccessible forum – the National Arbitration Forum, located in Minneapolis, Minnesota (the "NAF") – the arbitration provision was designed to, and effectively did, deny California consumers any real opportunity to present or to defend claims against Petitioners. Specifically, the evidence showed that after Petitioners filed claims against California consumers in the Minnesota forum, the NAF sent notification of the claim and invited the consumer to send in a written response to Minnesota. If a California consumer failed to send in a written response in the time allowed, a default award was entered through a purely administrative process. No arbitration occurred. If a consumer did send in a written response, jurisdiction was deemed conferred on the NAF in Minnesota, and an arbitrator sitting in Minnesota

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[3] This evidence was presented to the trial court in the form of sworn declarations and exhibits attached thereto. The full record was transmitted to the Court of Appeal.

would render an award based solely on the documents submitted. Under the NAF rules, no participatory hearing was ever held unless the consumer specifically requested such a hearing and submitted the minimum three-hour hearing fee of $750.00.

Although Petitioners asserted that California residents could request a hearing in their home district, and that indigent persons could obtain a waiver of the hearing fee, the evidence established that the NAF rules on these issues were unintelligible, ambiguous and misleading.[4] (Petition Appendix, at 8a.) Despite their attempts to justify the NAF rules regarding hearing fees, fee waivers, and hearing location, Petitioners failed to present any evidence that any California consumer had ever obtained a participatory hearing through the NAF, either in California or elsewhere. Rather, the evidence in the record, including declarations submitted by NAF personnel and the trial court's own records, established that, as a practical matter, Petitioners used the arbitration provision routinely to obtain default arbitration awards against California consumers through a purely administrative process at the NAF in Minneapolis, and then to convert those awards into judgments in California courts. Based on this evidence, and applying well-established principles of contract law, the trial court found the arbitration provision to be unconscionable and unenforceable, and

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[4] In the lower courts, Petitioners repeatedly characterized the NAF as "headquartered" in Minneapolis. No evidence was ever introduced, however, to indicate that the NAF had any office or facility other than the one located in Minneapolis. Nor was there any evidence presented of any NAF facility in California or of any NAF proceeding ever occurring in California.

on that basis denied Petitioner's motion to compel arbitration.[5] (*See* Petition Appendix, 14a-19a.)

On appeal, applying *de novo* review, the California Court of Appeal independently examined the evidence in the record, applied long-standing and well-established standards of unconscionability under California law that are applicable to contracts in general, and unanimously concluded that the arbitration provision was unconscionable as a matter of law and therefore unenforceable. (*See* Petition Appendix, at 3a-13a.) The court made this determination based on findings both as to the circumstances under which the arbitration provision was presented for signature to consumer borrowers, and the effect of the provision in discouraging and/or denying consumers any meaningful opportunity to present or to defend claims. Contrary to misrepresentations made by Petitioners, the court did not determine that the provision was unconscionable merely because it was a contract of adhesion. In fact, the Court specifically noted that "a contract of adhesion is still fully enforceable." (Appendix, at 5a.) Rather, the findings that the standardized contract was one of adhesion between parties of great disparity of bargaining power, that there had been no negotiation of terms, and that Respondents were unaware of the arbitration provision, were merely factors in the Court of Appeal's overall determination that the provision was procedurally and substantively unconscionable.

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[5] The trial court made no findings as to whether Respondents had consented to arbitration, or whether their signature on the arbitration agreements had been procured by fraud.

The decision of the Court of Appeal was based on the standard for determining unconscionability set forth in *A & M Produce Co. v. FMC Corp.*, 135 Cal.App.3d 473, 186 Cal.Rptr. 114 (Cal.App.4 Dist. 1982). This standard has long been held applicable to contracts generally, and was applied by the Court of Appeal to the arbitration provision just as it would have been applied to any other contract term. Furthermore, the standard for determining unconscionability set forth in *A & M Produce*, and applied by the Court of Appeal below, is derived directly from federal common law. (*See* discussion at II., *infra.*)

After their petition for rehearing was denied by the Court of Appeal, Petitioners petitioned the California Supreme Court for review. Although the California Supreme Court has made clear in recent years its unrelenting commitment to the enforcement of valid arbitration agreements, and its own strong endorsement of judicial policy favoring arbitration, that Court unanimously denied review in this case.

REASONS FOR DENYING THE WRIT

I. THE DECISION OF THE COURT OF APPEAL IS NOT IN CONFLICT WITH EITHER THE DECISIONS OF THIS COURT OR THE DECISIONS OF THE NINTH CIRCUIT AS TO THE APPLICABLE LAW IN DETERMINING THE VALIDITY OF ARBITRATION AGREEMENTS GOVERNED BY THE FEDERAL ARBITRATION ACT.

The decision of the California Court of Appeal is fully consistent with the provisions of the FAA, applicable

decisions of this Court, and the decisions of the Ninth Circuit Court of Appeals. As is explained below, the conflict Petitioners have attempted to create simply does not exist.

Section 2 of the Federal Arbitration Act specifically provides that an arbitration agreement is "valid, irrevocable, and enforceable, *save upon grounds as exist at law or equity for the revocation of any contract.*" 9 U.S.C. §2 (emphasis added). Thus, arbitration agreements are subject to the same general principles of contract law that would render any contractual provision invalid, unenforceable or revocable. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 625 (1985); *Southland Corp. v. Keating*, 465 U.S. 1, 16 n.11 (1984). In the past, this Court has cautioned that privately-negotiated agreements to arbitrate are "as enforceable as other contracts, *but not more so.*" *Volt Info. Sciences v. Bd. of Trustees*, 489 U.S. 468, 478 (1989), *quoting Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967) (emphasis added). There is no support in either the Federal Arbitration Act, or in the decisions of this Court, for Petitioners' contention that, as a matter of federal law, arbitration provisions are to be accorded special status and excused fundamental defects that would annul any other contract provision.

This Court has also specifically addressed and answered the issue Petitioners claim is raised by this Petition – whether it is state or federal law that is to be applied in determining if an arbitration provision is revocable "upon grounds as exist at law or equity for the revocation of any contract." 9 U.S.C. §2. This Court has consistently and repeatedly instructed that the preliminary determination of the validity of an arbitration agreement is to be made according to general principles of

state contract law. In *Perry v. Thomas, supra,* 482 U.S., at 492 n.9, this Court stated as follows:

> We also decline to address Thomas' claim that the arbitration agreement in this case constitutes an unconscionable, unenforceable contract of adhesion. This issue was not decided below, see nn. 4 and 6, *supra,* and may likewise be considered on remand.
>
> We note, however, the choice-of-law issue that arises when defenses such as Thomas' so-called 'standing' and unconscionability arguments are asserted. In instances such as these, the text of §2 provides the touchstone for choosing between state-law principles and the principles of federal common law envisioned by the passage of that statute: An agreement to arbitrate is valid, irrevocable, and enforceable, *as a matter of federal law,* see *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983), 'save upon grounds as exist at law or in equity for the revocation of *any* contract.' 9 U.S.C. §2 (emphasis added). Thus state law, whether of legislative or judicial origin, is applicable if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.

(Emphasis in original.)

Petitioners have asserted that this Court's very clear instruction in *Perry* was merely "dictum," and have falsely suggested that it conflicted with earlier decisions of this Court and other Courts of Appeal. (Petition, at 16.) In fact, the holding in *Perry* was fully consistent with earlier decisions of this Court. *See e.g., Mitsubishi Motors*

Corp. v. Soler Chrysler-Plymouth, supra, 473 U.S., at 627 ("Of course, courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract.' 9 U.S.C. §2."); *Southland Corp. v. Keating, supra,* 465 U.S., at 16 n.11. ("We agree, of course, that a party may assert general contract defenses such as fraud to avoid the enforcement of an arbitration agreement.). Furthermore, the *Perry* rule was subsequently referenced and reaffirmed in this Court's decision in *Volt Info. Sciences v. Board of Trustees, supra,* 489 U.S., at 475-76, a case conspicuously absent from the Petition, in which the Court stated:

> These cases of course establish that, *in applying general state-law principles of contract interpretation of an arbitration agreement within the scope of the Act, see Perry v. Thomas, 482 U.S. 483, 493, n.9,* . . . due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration.

(Emphasis added.) *See also Gilmer v. Interstate/Johnson Lane Corp.,* 500 U.S. 20, 111 S.Ct. 1647, 1656 (1991) (reaffirming the holding in *Mitsubishi Motors Corp.* that courts should remain attuned to well-supported claims of unequal bargaining power in determining the enforceability of an arbitration provision). Thus, this Court has made clear in *Perry v. Thomas,* and in decisions prior and subsequent to *Perry,* that the initial determination of the underlying validity and enforceability of an arbitration agreement is to be made according to general principles of state contract law.

The cases cited by Petitioners in their attempt to create the appearance of conflict are easily distinguishable. In *Moses H. Cone Memorial Hospital v. Mercury Construction Corp., supra,* 460 U.S. 1, and in the Ninth Circuit cases cited in the Petition, the issue addressed was whether a particular dispute was within the *scope* of the parties' admittedly valid arbitration agreement, (i.e., the "arbitrability" of the dispute). It is well-established that this is a separate issue that is to be decided as a matter of federal substantive law. This was first made clear in this Court's decision in *Moses H. Cone, supra,* 460 U.S., at 24-25. In that case, this Court stated as follows:

> The basic issue presented in Mercury's federal suit was *the arbitrability of the dispute* between Mercury and the Hospital. Federal law in the terms of the Arbitration Act governs that issue in either state or federal court.
>
> * * *
>
> The Arbitration Act establishes that, as a matter of federal law, any doubts *concerning the scope of arbitrable issues* should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability.

(Emphasis added.) *See also Mitsubishi Motors Corp., supra,* 473 U.S., at 626 (the decision as to whether a particular dispute is within the scope of the parties' agreement to arbitrate is to be made according to the federal substantive law of arbitrability); *Volt Info. Sciences, supra,* 489 U.S., at 475-76 (although general state-law principles govern basic interpretation of the validity of an arbitration

agreement, determinations as to the scope of the arbitrable issues under the agreement must be resolved according to federal policy favoring arbitration).

The Ninth Circuit cases cited by Petitioners all derive from this Court's holding in *Moses H. Cone*. The line of cases begins with *Bayma v. Smith Barney, Harris, Upham & Co., Inc.*, 784 F.2d 1023 (9th Cir. 1986), a case which preceded this Court's instruction in *Perry*, that it is state law principles that govern underlying issues of validity, by at least a year. 482 U.S., at 492 n.9. The issue presented in the *Bayma* case was whether an employment dispute was arbitrable under the terms of an arbitration agreement in an employee contract. The district court had found the provision revocable under state law. *Id.*, at 1023; *accord Hope v. Superior Court*, 122 Cal.App.3d 147, 175 Cal.Rptr. 851 (Cal.App. 1 Dist.), *cert. denied*, 456 U.S. 910 (1981). The Ninth Circuit, however, defined the issue as one of arbitrability, i.e., whether the employment dispute was arbitrable or whether it was exempt from the requirements of the arbitration provision. *Id.*, at 1024. Relying on this Court's holding in *Moses H. Cone*, the Ninth Circuit held that federal law applied on the issue of arbitrability and did not permit the state to carve out exceptions. The court concluded that, "[i]f the contract is one 'involving commerce,' then the question of arbitrability is controlled by federal law and not by state law." *Id.*, at 1025.

In *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282 (9th Cir. 1988), decided less than a year after this Court's decision in *Perry v. Thomas*, sophisticated investors attempted to avoid arbitration of their disputes with a stock brokerage firm. Although the court generally stated

that "the availability and validity of defenses against arbitration are therefore to be governed by application of federal standards," (841 F.2d at 285, *citing Bayma*), the court again defined the issue as primarily one of arbitrability of the issues, rather than the underlying validity of the agreement. *See e.g., id.*, at 285 (" '[Q]uestions of *arbitrability* must be addressed with a healthy regard for the federal policy favoring arbitration' "), *citing Moses H. Cone*, 460 U.S., at 24; *id.*, at 286 ("state law adhesion contract principles may not be invoked to bar *arbitrability* of disputes under the Arbitration Act"), *citing Bayma*, 784 F.2d, at 1024 (emphasis added).[6]

The Ninth Circuit also acknowledged in the *Cohen* decision that general principles of contract law apply to a court's determination of the underlying validity of an

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[6] There is clearly a recognizable distinction between the application of state law adhesion principles to the underlying validity of an agreement, and the application of such principles to a determination of the arbitrability of a particular dispute. As the California Court of Appeal recognized in this case, and as this Court has previously instructed, while contracts of adhesion are fully enforceable, "courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract.' 9 U.S.C. § 2." *Southland Corp. v. Keating*, *supra*, 465 U.S., at 16, n.11. In contrast, state law principles of adhesion are preempted by federal law when determining the scope of an admittedly valid arbitration agreement. Whereas state law would require that the scope of a contract provision be construed against the drafter, federal law requires that the scope of an arbitration agreement be broadly construed, such that "any doubts about the scope of arbitrable issues should be resolved in favor of arbitration." *Moses H. Cone Memorial Hosp.*, *supra*, 460 U.S., at 24.

arbitration provision. Like the Respondents in this case, the plaintiffs in *Cohen* also asserted that the arbitration provision at issue was unconscionable because the forum designated (the NYSE) was presumptively biased. The Ninth Circuit did not dismiss this contention as inappropriate under federal law. Rather, the court made a substantive determination that "because Congress has committed to the SEC the task for ensuring that the federal rights established by the Securities Acts are not compromised by inadequate arbitration procedures, we are bound by the commission's determination that the procedures at issue here are satisfactory." *Id.*, at 286. Similarly, in response to the plaintiffs' contention that their consent to the arbitration provision had been induced by fraud, the Ninth Circuit applied "traditional common law principles" and rejected the plaintiffs' claim of reliance. *Id.*, at 287.

Finally, in *Mago v. Shearson Lehman Hutton, Inc.*, 956 F.2d 932 (9th Cir. 1992), the primary issue was whether the plaintiff's Title VII claim was within the scope of arbitrable issues. Because the plaintiff also challenged the arbitration agreement as an unenforceable contract of adhesion, the Ninth Circuit again repeated its holding in *Bayma* and *Cohen* that "state law adhesion principles may not be invoked to bar arbitrability of disputes under the [Federal] Arbitration Act." *Id.*, at 956 F.2d, at 932 (citation omitted). The Ninth Circuit also acknowledged, however, this Court's instruction that " 'courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds for the revocation of any contract,' " *citing Gilmer v. Interstate/*

Johnson Lane Corp., supra, 111 S.Ct., at 1656, and remanded to the district court for a determination on the factual issue of adhesion. *Id.,* at 934-35.

Furthermore, in a case not cited by Petitioners, the Ninth Circuit explicitly recognized that is general state law principles that apply in determining the underlying validity of an arbitration clause. In *Teledyne, Inc. v. Kone Corporation,* 892 F.2d 1404 (9th Cir. 1990), a party to an arbitration clause sought to avoid arbitration by denying the existence of the contract as a whole. Citing *Prima Paint Corp., supra,* 388 U.S., at 402-04, the Ninth Circuit held that cases must be submitted to arbitration unless there is a challenge to the arbitration provision "which is *separate* and *distinct* from any challenge to the underlying contract." *Teledyne, Inc., supra,* 892 F.2d, at 1410. The court then noted that, under the Section 2 of the FAA, "general principles of law and equity" are relevant in determining whether there is an independent challenge to an arbitration clause, and that it is in this "narrow class of cases in which state law is relevant under the Federal Arbitration Act." *Id.,* at 1410-11.

Thus, like this Court, the Ninth Circuit has held that federal law applies when the issue presented is the *arbitrability* of a particular dispute governed by the FAA. When the issue presented is the underlying *validity* of an arbitration provision, however, as was the issue in this case, the Ninth Circuit has acknowledged that it is general principles of state contract law that govern such a determination. Accordingly, there is no conflict between the decisions of the Ninth Circuit and the opinion of the California Court of Appeal in this case.

Moreover, once this important distinction is made between the issues of underlying validity and arbitrability, the supposed conflict between the California Court of Appeal decision in this case and the decisions of other federal courts cited by Petitioners similarly evaporates. For example, in *Neal v. Hardee's Food Systems, Inc.*, 918 F.2d 34 (5th Cir. 1990), *reh'g. denied*, the court defined the issue presented as "whether the broad arbitration clause contained in the License Agreements entered into between the parties applies to the claims contained in Neal's petition pending in the district court." 918 F.2d, at 36. In a footnote, the court noted that "federal law applicable to this decision simply comprises generally acceptable principles of contract law. . . . We look to state law to shape these general principles." *Id.*, at 37-38, n.5 (citations omitted). *See also Eassa Properties v. Shearson Lehman Brothers*, 851 F.2d 1301, 1304 n.7 (11th Cir. 1988) ("While federal law may govern the interpretation and enforcement of a valid arbitration agreement, state law governs the question of whether such an agreement exists in the first instance."); *Cost Brothers, Inc. v. Travelers Indemnity Company*, 760 F.2d 58, 60 (3d Cir. 1985) (while federal law governs the construction of an arbitration agreement, the actual question presented was one of surety law to which state surety law applied); *Flink v. Carlson*, 856 F.2d 44, 46, n.2 (8th Cir. 1988) (the question of what persons are bound by an arbitration agreement subject to the FAA is a question of federal law, "but since that question involves the 'general law' of contracts and agency, federal courts look to state law in shaping federal law").

The illusion of conflict is further dissipated once proper distinctions are made between cases decided prior to this Court's 1987 decision in *Perry v. Thomas*, and those decided subsequent to the decision. *See e.g.*, Petition, at footnote 5, in which the Petitioners compare *Eassa Properties, supra*, 851 F.2d, at 1304, a case decided in 1988, with *In re Hart Ski Mfg. Co.*, 711 F.2d 845 (8th Cir. 1983), a one-page opinion decided in 1983, four years prior to *Perry*. Similarly, on page 16 of the Petition, the Petitioners criticize this Court's holding in *Perry* as inconsistent with *Coenen v. R.W. Pressprich & Co.*, 453 F.2d 1209, 1211 (2d Cir. 1972), *cert. denied*, 406 U.S. 949 (1972), a decision of the Second Circuit Court of Appeals that preceded this Court's decision in *Perry* by at least fifteen years.

The post-*Perry* decisions of the First and Fourth Circuits in *Securities Industry Ass'n v. Connolly*, 883 F.2d 1114 (1st Cir. 1989), *cert. denied* 495 U.S. 956 (1990), and *Saturn Distribution Corp. v. Williams*, 905 F.2d 719 (4th Cir.), *cert. denied* 498 U.S. 983 (1990), demonstrate that the Circuit Courts of Appeal have no difficulty in applying the *Perry* instruction. In those cases, the courts acknowledged the applicability of general principles of state contract law in determining the underlying validity of an arbitration provision, but invalidated state laws that imposed special restrictions on the formation of arbitration agreements. The decisions were thus fully consistent with both this Court's holding in *Perry* and with the decisions of other Circuit Courts of Appeal.

Thus, while federal courts have not always exercised a great deal of precision in describing when federal law applies to arbitration agreements governed by the FAA and when general principles of state contract law are

applicable, there is no actual conflict on this issue among the lower courts. This Court's holding in *Perry v. Thomas* settled the issue and need not be revisited.

II. EVEN IF THIS COURT INTENDED TO REVISIT THE ISSUE DECIDED IN *PERRY V. THOMAS*, THE COURT SHOULD NOT ISSUE A WRIT IN THIS CASE BECAUSE THE GENERAL PRINCIPLES OF STATE CONTRACT LAW APPLIED BY THE CALIFORNIA COURT OF APPEAL ARE NOT IN CONFLICT WITH FEDERAL LAW.

Even if this Court were inclined to revisit the issue it resolved in *Perry v. Thomas*, this case is not the proper vehicle for doing so. The doctrine of unconscionability applied by the California Court of Appeal in this case to invalidate the ITT arbitration provision is not unique to California law, is not uniquely applicable to arbitration agreements, and does not conflict in any way with federal common law. Thus, if this court intended to instruct state or federal courts further on the limitations of applying unique state law principles to arbitration agreements governed by the FAA, review in this case would not accomplish that purpose. Moreover, if the Court desired to reexamine the application of state law principles of contract interpretation to arbitration agreements governed by the FAA, the issue should be addressed in a case in which there is a clear conflict between the applicable state and federal law. No such conflict exists in this case.

The doctrine of unconscionability applied by the California Court of Appeal in this case, as set forth in *A & M. Produce Co. v. FMC Corp.*, *supra*, 135 Cal.App.3d 473, is derived directly from the Uniform Commercial Code and

federal common law. Indeed, in describing the doctrine, the *A & M Produce* court cited and relied heavily upon the well-known case *Williams v. Walker-Thomas Furniture Company*, 350 F.2d 445 (D.C. Cir. 1965), in which the court described the doctrine of unconscionability, as a matter of federal common law, in terms almost identical to those applied by the California Court of Appeal in this case.

> Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party.

Williams, 350 F.2d, at 449.

The *A & M Produce* case also notes that California's doctrine of unconscionability is derived from section 2-302 of the Uniform Commercial Code, which has long been applied by both federal and state courts to deny enforcement of unconscionable contract provisions. *See e.g.*, § 2-302 Uniform Commercial Code (West 1989); *Williams v. Walker-Thomas Furniture Company, supra*, 350 F.2d, at 449; *Industralease Automated & Scientific Eg. Corp., Etc.*, 58 A.D.2d 482, 396 N.Y.S.2d 427 (1977); *Geldermann & Co. v. Lane Processing, Inc.*, 527 F.2d 571, 575 (8th Cir. 1975). In *Geldermann & Co.*, the court explained that the doctrine of unconscionability as currently codified in U.C.C. § 2-302 originated in English common law, and was first approved by the Supreme Court in 1889 in *Hume v. United States*, 132 U.S. 406, 411 (1889). In describing the doctrine, the court in *Geldermann & Co.* emphasized the same considerations that formed the basis of the California's court's analysis in *A & M Produce Co.* – whether there was a gross inequity of bargaining power between the parties,

whether the aggrieved party was aware of and comprehended the provision in question, and whether the provision at issue was a commercially reasonable allocation of risks. 527 F.2d, at 575-76; *see also* 1 Arthur Corbin, *Corbin on Contracts*, § 128 (1992 Supp.); *Restatement Second Contracts* 2d, § 208, (1979).[7] Thus, the doctrine of unconscionability applied by the California Court of Appeal in this case is one of the most long-standing and generally-applicable principles of both federal and state contract law that "exist[s] at law or equity for the revocation of any contract." 9 U.S.C. § 2. Accordingly, regardless of whether the California Court of Appeal had applied state or federal common law, based on the evidence in the record, the result would have been the same.

This Court has always been mindful of the possibility of unfairness in the arbitration context, and has never held that arbitration provisions are necessarily exempt from general contractual principles of adhesion, oppression and unconscionability. Rather, this Court

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[7] In addition, it is clear that the analysis for determining unconscionability applied by the Court of Appeal was not uniquely applicable to arbitration provisions, but rather was applicable to contracts generally. The same analysis has been applied by courts in California to a variety of contractual provisions, including a provision requiring an unconscionable interest rate (*Carboni v. Arrospide*, 2 Cal.App.4th 76, 2 Cal.Rptr. 2d 845 (Cal.App. 1 Dist. 1992) *rev. denied*; a provision establishing an NSF bank charge (*Perdue v. Crocker National Bank*, 38 Cal.3d 913, 216 Cal.Rptr. 345, 702 P.2d 503, *appeal dismissed*, 475 U.S. 1001 (1985)); and a provision imposing a termination fee for an IRA account (*Dean Witter Reynolds v. Superior Court*, 211 Cal.App.3d 758, 259 Cal.Rptr. 789 (Cal.App. 1 Dist. 1989), *rev. denied.*)

has cautioned that allegations of oppression and unconscionability remain relevant, (*see Mitsubishi Motors Corp., supra,* 473 U.S., at 627; *Gilmer, supra,* 111 S.Ct., at 1656), and that determinations on these issues must be made in individual cases based on evidence in the record. *See e.g., Perry v. Thomas, supra,* 482 U.S., at 492 n.9 (claim of unconscionability to be considered on remand); *Gilmer, supra,* at 111 S.Ct., at 1656; *Rodriguez De Quijas v. Shearson/American Exp., Inc.,* 490 U.S. 477, 484 (1989).

The cases cited by Petitioners in which federal courts have enforced arbitration agreements alleged to be adhesion contracts are distinguishable in two important aspects – the relative sophistication of the adhering party, and the lack of any evidence supporting the claim of adhesion and unconscionability. *See e.g., Gilmer, supra,* 111 S.Ct., at 1656, (the record showed that Gilmer was "an experienced businessman" and did not contain any evidence of coercion in the signing of the arbitration clause); *Rodriguez De Quijas v. Shearson/American Exp., Inc., supra,* 490 U.S., at 484 (the record showed that plaintiffs were large-scale securities investors and contained no evidence that the contract was one of adhesion); *Passage v. Prudential-Bache Securities, Inc.,* 727 P.2d 1298, 1302 (Mont. 1986), *cert. denied,* 480 U.S. 905 (1987) (although brokerage agreement may have been one of adhesion, there was no evidence presented that it was oppressive or unconscionable); *Webb v. Rowland & Co., Inc.,* 800 F.2d 803, 807 (8th Cir. 1986) (contract of adhesion is only invalid if it is also unconscionable).

The evidentiary record in this case is markedly different. Respondents in this case did not merely assert that the arbitration provision was unenforceable because it

was a contract of adhesion. Rather, Respondents established through evidence in the record the specific manner in which the provision was procedurally and substantively unconscionable. This evidence established not only that the arbitration provision was a contract of adhesion, but also that Respondents were relatively unsophisticated, lower-income consumer borrowers who did not reasonably anticipate that an arbitration provision requiring arbitration in Minnesota would be contained in the loan documents they signed in California. More importantly, the evidence also established that, in operation and effect, the provision was substantively unfair and oppressive for the consumer parties. As the Court of Appeal found, by designating a distant, inaccessible, and prohibitively expensive forum, the arbitration provision appeared to have been designed to, and effectively did, deny California consumers any meaningful opportunity to present their claims or defenses. (Petition Appendix, 8a-9a.) Regardless of whether the Court of Appeal applied federal or state common law, the unique facts of this case clearly established grounds for denying enforcement of the arbitration provision.

III. THERE IS NO JUSTIFICATION FOR THIS COURT'S REVIEW BECAUSE THE CALIFORNIA COURT OF APPEAL DECISION IS UNIQUE TO THE PARTICULAR FACTS OF THIS CASE, DOES NOT CREATE PRECEDENT FOR THE STATE OF CALIFORNIA, AND DOES NOT EVIDENCE ANY STATEWIDE HOSTILITY TOWARD ENFORCEMENT OF ARBITRATION AGREEMENTS.

Despite Petitioners' attempt to portray this case as a frontal assault on arbitration agreements by California courts, the Court of Appeal opinion is clearly limited to the unique facts of this case and is of little or no precedential significance. It is not an opinion of the California Supreme Court, and has no binding precedential effect beyond the District in which it was decided. Nothing in the opinion below criticizes or conflicts in any way with precedent of other California Courts of Appeal or of the California Supreme Court.

Furthermore, the opinion neither stated nor implied any hostility whatsoever to arbitration agreements or to the arbitral process. Indeed, the opinion is utterly devoid of any broad statements about the arbitration process in general. Nor does the opinion assert any state law preemption of the provisions of the FAA. Rather, the Court of Appeal simply applied basic contract law to determine, based on the evidence in the record, the validity of a contractual arbitration provision. Because the evidence showed that, in this particular case, "the procedure seem[ed] designed to discourage borrowers from responding at all" and came "perilously close" to denying consumers a fair opportunity to present their claims,

the court found the provision to be invalid. (Petition Appendix, 8a-9a.) Given that most arbitration agreements designate a widely-accepted or well-known forum, equally accessible to both parties, it is highly unlikely that the obvious unfairness evident in this case would re-occur in any other case.

Petitioners' contention that "hostility to arbitration . . . still flourishes in the California courts" is clearly false.[8] (Petitioner, at 13-14) As the Court will note, Petitioners fail to cite any California case whatsoever in support of this assertion, and indeed, there are none. In fact, it would be difficult to imagine a more resounding endorsement of both the concept and the process of arbitration than is demonstrated by the California Supreme Court's recent opinion in *Moncharsh v. Heily & Blase*, 3 Cal.4th 1, 10 Cal.Rptr. 2d 183, 832, P.2d 899, *reh'g. denied*, (1992). In that case, the Court addressed the issue of whether, and under what conditions, a trial court was allowed to review an arbitrator's decision. *Id.*, at 8. The Court emphasized both the state's " 'strong public policy in favor of arbitration as a speedy and relatively inexpensive means of dispute resolution,' " (3 Cal.4th, at 9, citations omitted), and the importance of enforcing the parties' expectations of finality. *Id.*, at 10. The Court concluded that, except in the limited exceptions created by statute, an award reached by an arbitrator is not subject to judicial review *even if errors of law or fact are apparent on*

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[8] The contention is also an abrupt reversal of the argument strenuously asserted by Petitioners in each of the lower courts in this case that the California case law demonstrates a clear policy favoring the enforcement of arbitration agreements.

the face of the award, and even if those errors cause substantial injustice to the parties. Id., at 33.

Through *Moncharsh* and other decisions, the California Supreme Court and California Courts of Appeal have made clear the state's own strong judicial policy favoring arbitration, as well as the courts' respect for and deference to the arbitral process. *See e.g., Ericksen, Arbuthnot, Etc. v. 100 Oak Street*, 35 Cal.3d 312, 322-323, 197 Cal.Rptr. 581, 673 P.2d 251 (1983) (California has a strong public policy in favor or arbitration, and doubts concerning the scope of arbitrable issues are to be resolved in favor of arbitration); *Rowland v. Paine Webber, Inc.*, 4 Cal. App.4th 279, 284, 6 Cal.Rptr. 2d 20, (Cal.App.2 Dist. 1992) ("California has a strong public policy in favor of arbitration as a speedy and relatively inexpensive means of dispute resolution"; arbitration agreement would be enforced even though plaintiff claimed he was unaware of the provision and that his consent was obtained by fraud); *Izzy v. Mesquite Country Club*, 186 Cal.App.3d 1309, 1318-19, 231 Cal.Rptr. 315, (Cal.App. 4 Dist. 1986) (arbitration provision was not unconscionable and was fully enforceable even though plaintiff failed to read the provision before signing contract); *Bolanos v. Khalatian*, 231 Cal.App.3d 1586, 283 Cal.Rptr. 209 (Cal.App. 2 Dist. 1991) (arbitration agreement related to medical services would be enforced even though the patient had only limited reading ability and did not remember signing agreement; agreement would also be enforced against husband and child even though neither was a signatory to the agreement).

Thus, California courts have consistently and repeatedly enforced valid arbitration agreements. The opinion

of the Court of Appeal below denying enforcement of the ITT arbitration provision was clearly limited to the unique facts of this case and compelled by the evidence in the record. The decision does not conflict in any way with the FAA or with federal common law, and presents no basis whatsoever for this Court's review.

CONCLUSION

For all the foregoing reasons, this Court should deny the petition for writ of certiorari.

DATED: February 8, 1994

Respectfully submitted,

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No. 93-952

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

ITT CONSUMER FINANCIAL CORP., AETNA FINANCE CO., ITT LYNDON PROPERTY INS. CO., ITT LYNDON LIFE INS. CO., JOHN M. HIGGINS AND ASAD ZAFARI,
Petitioners,2

v.

ABBE KANAREK PATTERSON, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the California Court of Appeal, First Appellate District

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REPLY MEMORANDUM

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Statute:

Federal Arbitration Act, 9 U.S.C. §§ 1, *et seq.* ... *passim*

REPLY MEMORANDUM

Petitioners (collectively "ITT") file this memorandum in reply to respondents' brief in opposition:

1. The California Court of Appeal in this case applied state-law unconscionability principles to deny enforcement of arbitration agreements governed by the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1, *et seq.* ITT explained in its certiorari petition that this decision directly conflicts with the rule in the Ninth Circuit that the enforcement of arbitration agreements is governed exclusively by federal law, and implicates a larger disagreement among federal and state courts as to when, if ever, state law may be used to deny arbitration enforcement. In opposition, respondents rely on mischaracterization of case law and a meaningless rule of decision of their own creation to argue that the courts are in harmony. One need only read the relevant decisions to refute respondents' claim absolutely; there is a real and important split of authority that this Court should resolve.

a. There is an express and direct conflict between the California Court of Appeal decision in this case and decisions of the Ninth Circuit. Petition at 8-14. The Ninth Circuit rejects explicitly any application of state-law adhesion and unconscionability principles to bar arbitration under the FAA. *E.g., Mago v. Shearson Lehman Hutton Inc.*, 956 F.2d 932, 934 (9th Cir. 1992) ("state law adhesion principles may not be invoked to bar arbitrability of disputes under the [FAA]") (internal quotations omitted). The California Court of Appeal applied state-law principles of adhesion and unconscionability in this case.

Unable to avoid this obvious conflict, respondents resort to gross mischaracterization of the relevant Ninth Circuit authority. Nowhere is this more evident than in respondents' misquotation of the Ninth Circuit's recent decision in *Mago, supra*. Respondents contrast the statement from *Mago* quoted above—concerning the inapplicability of state law—with the following statement from the same opinion: "courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds for the revocation of any contract." 956 F.2d at 934 (internal quotations omitted), quoted in Opp. at 17. The clear implication of respondents' quotation is that the *Mago* court, like the California Court of Appeal here, was looking to state law on these questions. But respondents have deliberately failed to include the Ninth Circuit's introduction to the quoted passage, in which the court reiterated that federal, not state, law is applicable: "[A]n arbitration agreement may be unenforceable under principles of *federal law*:" 956 F.2d at 934 (emphasis added). The contrast with the California Court of Appeal decision in this case could not be more stark.

Respondents attempt much the same sleight of hand with *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282 (9th Cir. 1988). The Ninth Circuit there rejected the Cohens' claim that the arbitration clause in a loan agreement was "unenforceable as an unconscionable provision of a contract of adhesion." *Id.* at 285. Respondents argue that "[t]he Ninth Circuit did not dismiss this contention as inappropriate under federal law," but rather decided the issue solely on the basis that the SEC had authorized the arbitration proce-

dures at issue. Opp. at 17. Respondents' description of *Cohen* is incomplete and therefore demonstrably incorrect. Following the discussion of SEC authorization, the Ninth Circuit announced a separate ruling on the Cohens' adhesion claim, a ruling that conflicts directly with the California Court of Appeal decision in this case: "Our conclusion [regarding SEC authorization] is not affected by the Cohens' contention that the arbitration agreement is a part of a contract of adhesion. We have previously held that state law adhesion contract principles may not be invoked to bar arbitrability of disputes under the Arbitration Act." 841 F.2d at 286.

b. Respondents fare no better when they attempt to explain away the clear divergence among state and federal courts, and indeed within the decisions of this Court, on the broader issue of when, and under what circumstances, state law may be invoked to deny arbitration enforcement. Respondents create, and then exclusively rely upon, a specious distinction between the "validity and enforceability" of arbitration agreements on one hand, and the "scope of arbitrable issues" on the other. Opp. at 2, 13. According to respondents, *Perry v. Thomas*, 482 U.S. 483 (1987), and other decisions of this Court establish that the "validity and enforceability" of arbitration agreements is to be determined by state law, while the "scope of arbitrable issues" is a matter of federal law, Opp. at 12-13, and respondents claim there is no confusion about this rule among other federal and state courts. *Id.* at 14-21.

Respondents' distinction is false both as a matter of law and as a description of what the courts have held. The distinction is meaningless as a matter of

contract law because the scope of issues covered by an arbitration clause *is* a question of contract enforceability; if courts apply federal law to the question of the scope of arbitrable issues (or "arbitrability" as respondents sometimes refer to it), they are by definition applying federal law to determine whether, and to what extent, an agreement should be enforced. For example, respondents claim that the issue in *Cohen, supra*, was "primarily one of arbitrability of issues," and not validity or enforceability. Opp. at 16. The Ninth Circuit did indeed discuss "questions of arbitrability" in that case. 841 F.2d at 285 (internal quotations omitted), quoted in Opp. at 16. But the court was referring to the question whether the arbitration clause at issue was "unenforceable as an unconscionable provision of a contract of adhesion." 841 F.2d at 285.[1] Thus, there is no distinction between "arbitrability" and enforcement of an arbitration agreement.[2]

More important than their failure of nomenclature, respondents are flat wrong when they claim that the

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[1] The same is true of *Bayma v. Smith Barney, Harris Upham and Co., Inc.*, 784 F.2d 1023 (9th Cir. 1986). While the Ninth Circuit there "defined the issue as primarily one of arbitrability," as respondents assert, Opp. at 15, the issue was whether an "arbitration clause was a contract of adhesion." 784 F.2d at 1023.

[2] Respondents cite *Teledyne, Inc. v. Kone Corp.*, 892 F.2d 1404 (9th Cir. 1990), as consistent with their "validity and enforceability" rule. Opp. at 18. However, *Teledyne* involved the question whether a contract *existed*—not whether an existing contract was valid and enforceable. 892 F.2d at 1410-11. The existence of the arbitration agreements in the case at bar was not at issue; the only issue was whether the agreements were unenforceable because allegedly unconscionable. *See* Petition at 12 n.5.

courts are in agreement that the validity and enforceability issue is a matter of state law. Respondents may find their "validity and enforceability" rule clearly established, but the courts have not. ITT cited in its petition more than a dozen cases in which federal and state courts have applied *federal* law to the enforcement of arbitration agreements. Petition at 13 & 14 n.7.[3]

Moreover, ITT cited more than a half dozen federal and state cases applying federal law to the question of unconscionability, precisely the issue of "validity and enforceability" that respondents claim is clearly controlled by state law. Petition at 13. Whatever the merits of respondents' asserted "arbitrability-enforceability" distinction, and no matter how one categorizes questions of unconscionability, respondents cannot deny that numerous courts have applied federal law to the issue of unconscionability of arbitration

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[3] *See, e.g., Genesco, Inc. v. T. Kakiuchi & Co., Ltd.*, 815 F.2d 840, 845 (2d Cir. 1987) ("[i]n enacting the Federal Arbitration Act, Congress created national substantive law governing questions of the validity and the *enforceability* of arbitration agreements under its coverage") (emphasis added); *Cost Brothers, Inc. v. Travelers Indem. Co.*, 760 F.2d 58, 60 (3d Cir. 1985) ("questions of the construction of arbitration agreements and their *enforceability* are governed by federal substantive law") (emphasis added).

Remarkably, respondents cite and quote *Eassa Properties v. Shearson Lehman Brothers*, 851 F.2d 1301, 1304 n.7 (11th Cir. 1988), for the proposition that "federal law . . . govern[s] the interpretation and *enforcement* of a valid arbitration agreement" (emphasis added), just pages after they claim that it is well established that the "enforceability" of arbitration agreements is a matter of state law. *Compare* Opp. at 13 *with* Opp. at 19.

agreements, in direct contravention of the California Court of Appeal decision here.

This Court also has indicated that enforcement of arbitration agreements is a matter of federal law. *E.g., Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984) ("[i]n creating a substantive rule applicable in state as well as federal courts, Congress intended to foreclose state . . . attempts to undercut the enforceability of arbitration agreements"); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625-26 (1985) ("The preeminent concern of Congress in passing the [FAA] was to enforce private agreements into which parties had entered, a concern which requires that [courts] rigorously enforce agreements to arbitrate.") (internal quotations omitted). At the same time, dictum in *Perry v. Thomas* indicates that arbitration-neutral *state* law may be applied to the "enforceability" of arbitration agreements. 482 U.S. at 492 n.9.

This apparent inconsistency between *Perry* and other pronouncements from this Court has led to confusion in federal and state courts.[4] While most courts apply federal law exclusively to arbitration enforcement questions,[5] the First and Fourth Circuits look

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[4] *See, e.g., Meyers v. Univest Home Loan, Inc.*, No. C-93-1783 MHP, 1993 WL 307747 *2-3 (N.D. Cal. Aug. 4, 1993) (applying federal law to the question of unconscionability of arbitration agreements, but noting tension between Ninth Circuit rule and *Perry*).

[5] Respondents argue that some of these cases can be distinguished because they were decided before *Perry*. Opp. at 15, 20. (This distinction is self-contradictory; respondents earlier in their brief contend that the "validity and enforceability" rule had been well established by Supreme Court cases prior to *Perry*.

to arbitration-neutral state law. Petition at 17-18. Respondents' meaningless "enforceability" versus "arbitrability" distinction does nothing to harmonize these cases. There is real confusion in the lower federal and state courts, and some inconsistency in the decisions of this Court, that the Court should clarify.

2. That this case implicates a clear split of authority between the California courts and the Ninth Circuit and a more general confusion among federal and state courts is reason enough for this Court to take the case. But the decision below is particularly dangerous because it is contrary to the strong federal policy favoring arbitration. Petition at 8-13, 18-20. The California Court of Appeal decision represents a return to the "anachronistic judicial hostility to agreements to arbitrate," that the FAA was designed to overcome. *See Mitsubishi Motors*, 473 U.S. at 625 n.14.

a. Respondents contend that the Court of Appeal decision is nothing more than run-of-the-mill appli-

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Opp. at 13.) Most cases ITT cites are more recent than *Perry*; and respondents fail to address the bulk of them.

One case respondents dismiss as a relic of the benighted pre-*Perry* days is *Coenen v. R.W. Pressprich & Co.*, 453 F.2d 1209 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972). Opp. at 20. The *Coenen* court explained that "[o]nce a dispute is covered by the [FAA], federal law applies to all questions of interpretation, construction, validity, revocability, and enforceability." *Id.* at 1211. ITT cited *Coenen* not merely as Circuit authority, but as *Supreme Court* authority; this Court cited *Coenen* as a proper exposition of federal law in *Moses H. Cone Memorial Hosp. v. Mercury Constr. Co.*, 460 U.S. 1, 25 n.31 (1983). If respondents believe that the *Perry* dictum may be read to overrule *Moses H. Cone sub silentio*, that is all the more reason for the Court to take this case.

cation of settled unconscionability principles to a unique set of facts. Opp. at 21-29. In fact, the decision below was an unadulterated attack on arbitration rules and procedures, based on unsubstantiated fears that those procedures did not afford adequate protection to hypothetical parties.

Respondents presented a purely facial challenge to NAF rules and procedures; respondents claimed unconscionability not because they had been misled or suffered any unfairness as a result of the procedures, but because the arbitration procedures *in the abstract* might mislead. Respondents presented no evidence that these procedures had ever worked any unfairness against anyone.[6] The Court of Appeal ruling on this abstract challenge is, by definition, not "limited to

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[6] Among the allegedly misleading procedures about which respondents made no showing was the site of arbitration. Respondents now assert that California residents were "required . . . to submit to arbitration in a forum located in Minneapolis, Minnesota." Opp. at 2. This is simply not true. The Court of Appeal acknowledged that the relevant NAF rule, as referenced in the arbitration agreements, permits a hearing in the judicial district where the arbitration agreement was signed. Pet. App. 7a. Respondents argued, and the court below agreed, that this provision *might* confuse borrowers, but no one ever contested that respondents could have arbitrated their disputes in San Francisco had they so chosen. The fact is, respondents never read their arbitration agreements or attempted to arbitrate their disputes in San Francisco or anywhere else and therefore could make no showing that they had been misled by the NAF rule in question. Nor did respondents show that anyone else had ever been misled by that rule. Respondents' attack, and the court's ruling, were based solely on speculation that the rule might be unfair if it were misconstrued by hypothetical borrowers. Any court applying a presumption in favor of arbitration, as the FAA demands, could not have reached this conclusion.

the unique facts of this case." *See* Opp. at 4. It is judicial hostility toward arbitration *simpliciter*.

b. Respondents also argue that the California Court of Appeal decision is consistent with unconscionability decisions under federal law. Opp. at 21-24. But under federal law there is a presumption in favor of arbitration. *Moses H. Cone*, 460 U.S. at 24-25. It is for this reason that ITT was able to cite numerous cases applying federal law to uphold arbitration agreements against unconscionability attacks, Petition at 13, and respondents were unable to cite even one case applying federal law to find an arbitration agreement unconscionable. In the absence of any showing of actual harm or unfairness, as was the case here, and with a presumption in favor of arbitration, any court applying federal law will enforce arbitration agreements. The California Court of Appeal displayed judicial hostility toward arbitration and applied unconscionability principles that are directly *contrary* to federal law.

CONCLUSION

For the foregoing reasons and those set forth in ITT's petition, the Court should grant a writ of certiorari and set the case for plenary review.

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Respectfully submitted,

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